Carnegie Endowment for International Peace

DIVISION OF ECONOMICS AND HISTORY

PRELIMINARY ECONOMIC STUDIES OF THE WAR

THE FINANCIAL HISTORY OF GREAT BRITAIN, 1914-1918

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Carnegie Endowment for International Peace

DIVISION OF ECONOMICS AND HISTORY

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PRELIMINARY ECONOMIC STUDIES OF THE WAR

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THE FINANCIAL HISTORY OF GREAT BRITAIN, 1914–1918

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EDITOR'S PREFACE

President McVey's study is one of the series of preliminary war studies planned by the Carnegie Endowment for International Peace to assist in showing our own people some of the early experiences, policies, and effects of the war. It sets forth the financial experience of Great Britain from the beginning of the war to the spring of 1918. The attention of the student of British efforts and experience will be arrested at once by several important points in the story. He will be struck first with the immensity of the burden which the British people have voluntarily assumed in defense of their empire, their ideals and their international obligations. If before the war anyone had prophesied that even so wealthy a people as the British could or would submit to war expenditures on so stupendous a scale, he would have been laughed at. A second point that will impress itself is that in spite of the arguments of Block and writers of his school, the mounting expense of modern war is not, after all, a very strong or primary deterrent of conflict. The third point which will arrest attention is the financial strength and resourcefulness of the British Empire. Her far-flung battle line is paralleled by her far-flung commercial and financial line of influence and power. As her children have gathered from all quarters of the world to her defense in battle, so her financial resources have come from equally diverse and distant quarters to support them. Without her foreign investments to draw on Britain would undoubtedly have been seriously crippled before this. Still again, one will be struck with the fact that this burden of taxation has been borne cheerfully, in accordance with the determination of the people and their government to pursue their purpose in the war to a conclusion.

Of course, much of the British financial strength has come from the United States. This was true even before we were

active participants in the war. It is more so now because of the direct loans which our government has made to the British.

The British war financial policy on the whole has been sound, from the point of view of financial science. They have pushed taxation to the limit and have relied on loans for the balance. Fortunately, we are likely to follow the same policy instead of making the mistake which we have made in our previous wars, and which Germany appears to have made in this war, of trying to finance the war primarily from the proceeds of long-time loans. The latter policy stimulates speculation, breeds inequalities of wealth by enabling some to become rich at the expense of the country through taking advantage of its war necessities, and, finally, throws an undue burden upon the future.

President McVey's study is a clear and interesting exhibit of the financial strength of our great ally and reveals in part the great sacrifices she has made in the war. It throws light, too, on the vastness of the burden we ourselves shall have to carry.

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THE FINANCIAL HISTORY
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CHAPTER I

Immediate Financial Difficulties

The comment of periodicals, newspapers, and publicists in July, 1914, shows that the war was a surprise to the banker, the capitalist, the politician, and the man in the street. That it should have been so, in light of all the facts, will always be a nine days' wonder to the student of history. For forty years Germany had been preparing for "the day" behind her screen of language, intrigue, and commercial policy. The two Balkan Wars had added materially to the probability of trouble and why the statesmen of Europe had not anticipated the difficulty leaves a question long to be unanswered.

The Beginning of the War

On Friday, July 24, Austria sent its ultimatum to Serbia, which was followed by a declaration of war against Serbia on July 27. The German ultimatum to Russia followed on the 31st. On August 2, Germany violated the neutrality of Luxemburg; on the 3d, her troops entered Belgium; and on Tuesday, the 4th of August, 1914, England joined Russia and France at war with the Prussian Power. This simple statement of the facts is merely introductory to the momentous events that ensued. There followed a series of incidents, acts, and declarations that modified, overturned, and destroyed commerce, business, and institutions, to say nothing of the lives, wealth and happiness of people in a dozen lands; and then upon Great Britain as the chief state of the Allied Powers there fell enormous burdens of diplomacy, finance, and military and moral preparedness.

The Plan of Discussion

These burdens, broadly speaking, so far as this book deals with them, were of two kinds: one, commercial and business finance, and the other, the great task of providing the necessary funds to meet the expenses of the war. The first group of problems, those of commercial adjustments, were precipitated upon the government; business was demoralized and in the end the raising of funds, either by taxation or by borrowing, depended upon the continuance of business under as normal conditions as the circumstances warranted. The situation was unusual, and unusual methods were necessary to bring order out of the chaos. This and the following chapter deal with the legislation enacted to remedy the situation. Succeeding them the discussion proceeds to the consideration of the problems of public finance raised by the war.

Adherence to public finance in the strict sense of the term would confine this discussion to taxation and public borrowing. These in themselves are sufficient for a volume much larger than this one, but the real genius of the English Government to meet situations would be passed by if the earlier emergency legislation were omitted from consideration. These problems are in a measure not public finance, yet the war practically made them so by enlarging the field of government financial operation. In consequence, the first two chapters are devoted to the financial difficulties of August, September, October and November, 1914. As the budget is the device by which the English inaugurate their expenditures it appears desirable to discuss the nature of the budget and the extent of expenditures in carrying on the war. The cost of the war is closely associated with the various grants, or votes of credit, and from this the discussion naturally proceeds to war loans and plans of taxation. The dollar security scheme appears to be out of the realm of public finance, but the necessity of maintaining exchange became, in the case of the United Kingdom, a question of public finance, a matter of vital importance to the scheme of war finance. The same is true of

inflation and the price of commodities. With this word of explanation the plan of presentation may be laid down in outline form.

I. Emergency legislation arising out of the national crisis
   1. The moratorium
   2. Currency and bank notes
   3. The stock exchange situation
   4. Courts Emergency Act
   5. Shipping insurance

II. Public finance problems
   1. The budget
   2. Votes of credit and the war cost
   3. War loans and dollar securities
   4. Taxation

III. Some financial effects of the war
   1. Prices and inflation
   2. On organization and accounting
   3. Trade and government policy

In order to show what happened to the English business world when war was declared, it is desirable to describe briefly some of the economic conditions existing before August, 1914.

Financial and Business Conditions Prior to the War

Financial matters had gone from hot to cold and back to hot in the operations that were being undertaken prior to the year 1914. England had developed an enormous expansion of international trade with the consequent increase in banking operations; a great flood of new enterprises had been brought to the attention of the financial world; public borrowing had grown to huge proportions and at the same time investors suffered heavy losses through bad management, defaulting states, wars and penal taxation.[1]

During the first six months of 1914 the political horizon which had been long obscured appeared to have cleared and money,

[1] Lawson: *British War Finance*, 1914-15, p. 22.

much frightened by the Balkan Wars and fears of other complications, again circulated with more freedom. There was an improved tone in the security markets and it was hoped that the cycle of depreciating years was at an end.[1]

Nevertheless, the general financial conditions in July, 1914, were unsatisfactory. The French banking houses involved in the Balkan Wars had little free money for financing. They were in fact engaged in accumulating gold. A heavy indebtedness abroad prevented New York from accomplishing much in the way of assistance, which, under normal times, would have been given by frequent remittances charged against exports of grain. The Paris bankers were selling American securities in order to strengthen their gold holdings.[2] But it was not until July 27, that the London money market began to adopt means to protect its interests. Almost at once market quotation on mercantile paper went 1 per cent above the bank rate. Paris exchange fell to 25f. 5c., and New York exchange rose to $4.93. Gold was withdrawn for shipment to Egypt and the continent. On the 30th the bank rate advanced from 3 to 4 per cent. The proportions of reserve to loans in the bank statement fell to 40 per cent. Bills sold to the bank at 6 per cent, then at 10 per cent. On the 31st the New York and London stock exchanges closed, preceded three days before by the exchanges in Vienna and Paris.

> Nothing could have testified more clearly to the impossibility of running modern civilization and war together than this closing of the London stock exchange produced not by the actual outbreak of a small war, but by the fear of a war between some of the great Powers of Europe.[3]

The Immediate Tasks

The immediate burden laid upon Great Britain as a consequence of the war was a heavy one. Those of military importance were to keep command of the sea, to place an army in

[1] *The Times*, London, January 22, 1915.
[2] *The Times History of the War*, vol. i, p. 171.
[3] *London Economist*, August 1, 1914, p. 219.

the field, and to assist her allies by furnishing supplies and aiding them to finance purchases in countries other than their own. The financial problems were hopelessly mixed and dovetailed. The economic machinery was thrown out of gear, and the mechanics of buying and selling, of transporting, of banking and finance stopped like an unwound clock. To get it to go was the problem. It was necessary to protect bills of exchange in circulation and maturing, to provide safety for stock exchange transactions and to smooth out the difficulties of domestic trade.

With courage and decision the government took up the task.[1] The problems shaped themselves into the immediate ones of making every day credit a going force, relieving pressure on markets and finance and keeping ships moving even in the face of great risks.

> The method and machinery of the war legislation was of the profoundest constitutional importance. Such legislation in the Elizabethan age had been chiefly effected by the Queen in Council, in the age of Pitt by the King in Parliament. In this as in all other matters, the early decades of the twentieth century were an eclectic age. Statesmen ransacked the records for new methods of legislation. There was hardly a possible form of legislative activity to which the government of Great Britain had not to resort in order rapidly to create an economic screen between the nation and the war zone and at the same time to carry on the great war with efficiency. Success in the field and on the sea was not alone necessary. It was equally necessary to preserve national life immune from social and economic dislocation.[2]

The Banks and Bills of Exchange

The position in which Great Britain found herself on the last day of July was without parallel. The Bank Holidays were at hand and the whole populace was calling for funds to finance its expeditions into the country. The joint stock banks began paying in notes and refusing gold, forcing upon the Bank of

[1] See speech of Lloyd George and debate, *Parliamentary Debates*, H. C., November 27, 1914.

[2] *The Times History of the War*, vol. vi, p. 49.

England the burden of gold payment in exchange for the notes secured from the banks. In view of the hardening of liquid assets mainly in the form of bills of exchange and securities held by banks, this was not unexpected. In the week ending July 30, consols had fallen from 75 to below 70 and the 387 securities listed in the *Bankers' Magazine* fell an average of 5.67 in the ten days from July 20 to 30. The stock exchange was at the same time flooded by securities from the continent and its continuance meant decline of values as well as further calls from the banks for greater margins on their loans. The closing of the exchange made securities unsalable and froze the banks' collaterals as liquid assets.

Another asset held by the banks was the bills of exchange arising from the conduct of international trade. In ordinary times these were regarded highly as first class assets. The exchange system having broken down, foreign debtors were unable to remit to England.[1] Such a condition pointed to the necessity of the great private accepting houses meeting the bills they had accepted from their own assets. The banks' assets were largely unrealizable and those of the accepting houses pretty much in the same predicament. The bankers therefore found themselves with weakened assets on one hand and a rapidly growing demand for money and a possible call upon them to pay the bills of exchange held by them on the other.

> By means of bills of exchange drawn upon London, grain, manufactured goods, metals, coal, oil, rubber and other articles required by civilized and uncivilized man, are carried over the seven seas to their ultimate destination and to the final consumer. Now, the sellers of these goods can not, as a rule, wait for the money due them until dealers finally realize upon their purchases. The London money market—that is the banks, the bill brokers and the acceptance houses—provides the capital necessary to carry on this vast international trade. In other words, Lombard Street buys and sells bills of exchange, through which and by means of which foreign trade is carried on.

[1] *Bankers' Magazine*, September, 1914.

> London has made a specialty of international bills of exchange and these bills are regarded as good as gold in every quarter of the world. German, Austrian, Russian, French, and other dealers, arrange with London accepting houses to accept the bills that are to pay for goods bought in countries all the way from China to Peru. For example, a Hamburg merchant buying cotton from Texas, or coffee from Brazil, or wheat from Argentine, or silk from China, or opium from India, or cocoanut oil from the South Sea Islands, or ostrich feathers from South Africa, arranges with an English acceptance house to accept the drafts which are to pay for these commodities. The English acceptance house, while accepting the draft for the Hamburg merchant, and thus becoming liable for its payment, requires him to sign a certificate guaranteeing that, through his banker, or otherwise, he will put the acceptance house in possession of funds shortly before the bill is due, generally three days before it matures. In the meantime the Brazilian or other seller of the goods gets a first-class financial document, guaranteed by a strong financial English institution. These bills, which, as a rule, run for a period of three months, can be immediately discounted by the exporter, who thus receives his money at once. On the other hand, the Hamburg importer gets possession of the goods as he signs the certificate guaranteeing to put the English acceptance house in possession of funds to meet the draft when it becomes due. Having secured the goods, he either sells them, or manufactures them into finished product; and before the three months' period is up, he has realized a sufficient sum from the sales he has effected to meet his obligations in London. The English acceptance house, of course, receives a commission for carrying out its share in such transactions. London levies an enormous toll upon the commerce of the world which flows in this way through her gates.[1]

As a consequence of this brief statement of the meaning of bills of exchange in English financial history, the reader will be in a better position to appreciate the anxiety of bankers and of the government to maintain their value and movement in the stream of business.

The banks began calling on the bill brokers for the payment of

[1] W. W. Swanson: *The Financial Power of the Empire,* pp. 5-6.

the loans made to them on the endorsers and accepting exchange bills as soon as the war clouds appeared. In turn, the brokers went to the Bank of England. In normal times there is about £100,000,000 loaned in London on short term bills, but in the ten days, ending August 1, the Bank of England increased its loans £31,700,000.[1] The bank rate rose rapidly from 4 per cent on Thursday, to 8 per cent on Friday, and to 10 per cent on Saturday, August 1. Meantime the public was running to the banks, and since the banks refused to pay gold to their customers the public took the notes given to it to the Bank of England for exchange in gold. In a brief time the Bank of England lost £16,000,000 in notes and sovereigns with a resultant fall in reserve to less than £10,000,000. The situation was more than serious, it looked disastrous. In previous crises, the government had suspended the Bank Act of 1844 and allowed the Bank of England to issue notes. The public began to hoard money and call for further amounts, but the currency was not at hand. Neither the Bank nor the Treasury had a supply ready for the emergency.[2] The first necessity was time and to this end the Bank Holidays were extended to August 6 by royal proclamation.

The Moratorium

In his speech in the House of Commons on November 27, 1914, Lloyd George said, "We first declared a moratorium, a limited moratorium, so as to give us time to look around."[3] In the interval before legislation could be enacted a royal proclamation was issued under date of August 2, authorizing the postponement of certain bills of exchange.[4] On the following day, Parliament enacted the Postponement of Payments Act[5] and legalized the proclamation. On the 6th of August, the Currency and Bank Notes Act was passed[6] and on August 31, the

[1] See discussion, Withers: *War and Lombard Street*, pp. 31-37.
[2] *London Gazette*, August 4, 1914, p. 6064.
[3] *Parliamentary Debates*, H. C., November 27, 1914.
[4] *London Gazette*, August 2, 1914, p. 6049.
[5] 4 and 5 George V, chap. ii.
[6] 1914 (4 and 5 George V).

Courts Emergency Powers Act. These three acts with the accompanying proclamations and Bank memoranda comprise the first phase of war legislation for financial purposes. What the Chancellor of the Exchequer called a limited moratorium became by reason of the extensions of the acts a general moratorium of far reaching character.

Insistence upon payment by acceptors or guarantors in view of the demoralization of exchange the world over would have brought the house of cards completely to the ground. A system based upon peace conditions became in time of war a flimsy structure, likely to collapse by undue pressure from any of a dozen points. The provisions of the moratorium and the allowance of reasonable time in which to collect the debts due the accepting bank tended to restore confidence. It was vital to England's good name and her future credit that this should be done. The best agency for the conduct of this part of the plan of reconstruction was the Bank of England, which, by reason of the rapid development of joint stock banking, had lost to some extent its prominent position in English finance. Under the conditions existing in August the bank immediately emerged from its comparative seclusion and took a leading part in reestablishing credit. The accomplishments of the bank were many, but specifically it (1) paid gold for notes issued by other banks, (2) conducted the issue of Treasury notes, (3) carried on extended rediscounting operations, (4) cashed notes for Belgians, (5) issued huge war loans and assisted in the consultations with the bankers and government.[1]

Under the provisions of the Postponement of Payments Act and its extensions by proclamation, the problems of exchange, the restoration of the stock exchange and the postponement of debt payments were arranged and provided for.

In restoring exchange two alternatives were open to the government.[2] One was for the state to become the banker and to

[1] *The Times,* January 22, 1915.
[2] Lloyd George in speech of November 27, *Parliamentary Debates,* H. C., November 27, 1914.

guarantee British acceptances against produce after the commencement of the war. Such a method would have been nothing more than using existing machinery, hypothecating state credit and making the state the guarantor of the transactions of the banks and accepting houses. The other method, and the alternative, was the restoration of the old machinery by releasing endorsers and drawers and retaining the liability of acceptors. When this was accomplished the endorsers and drawers would be free to undertake new business. This part of the plan did not come into full force until September 5, when the government issued a memorandum stating what the bank would do in rediscounting accepted bills.

The first step in the restoration of confidence was the general postponement (August 3, 1914)

> of the payment of any bill of exchange, or of any negotiable instrument, or of any other payment in pursuance of any contract, to such an extent, for such a time, and subject to such conditions or other provisions as may be specified in the proclamations . . . This act may remain in force for a period of six months from the date of the passing thereof.

The royal proclamation of August 2, 1914, limited the postponement of payment to bills of exchange other than a check, or bill, or demand and provided that the acceptor automatically re-accepts the bill for a period of one month. The proclamation of August 6 was more specific and enumerated the forms of payments to which the Postponement of Payments Act did not apply.[1] Among these were wages, liabilities less than £5 in amount, rates or taxes, maritime freight, debts of a personal character due from persons outside the British Isles, dividends, liabilities of banks on notes of issue, payments by the government, payments by societies organized under the National Insurance Act (1911) and the Workmen's Compensation Act, 1906, and payments of depositors in trustee savings banks. The proclamation of August 12 extended the postponement of payments

[1] *London Gazette*, August 7, 1914, p. 6190.

to any banks whose principal place of business was in any part of his Majesty's Dominions or any British protectorate.[1] On the 3d of September another proclamation extended the time of nonpayment for an additional month,[2] and on September 30 the royal proclamation of that date authorized a final extension of time to November 4, 1914, though calling upon all persons who can to discharge their liabilities without delay. The payments of rent and amounts due from or payable to a retail[3] dealer were specifically excluded from the provisions of the proclamation.

Postponement of payments could not by the very nature of the situation be anything more than an opportunity to catch breath. The maintenance of the accepting houses was vitally important to the continuance of international trade upon which England depended for her supplies and much of her financial support. So it was arranged that the Bank of England might lend the accepting houses money to pay the bills when they fell due, the government guaranteeing the bank against loss on the transaction. By this arrangement the bills held by the joint stock banks once more became an asset and relieved the pressure the banks were bringing on the bill brokers.[4]

Part of the process has already been described, but the hope of a betterment of the situation during the period of the extension of the acceptance date proved disappointing. The discount market came to a standstill. To meet this situation it was announced on August 13 that the Bank of England would discount approved bills that had been accepted before August 4 without recourse to the holder,[5] and upon their maturity the bank would give the acceptors the opportunity until further notice of postponing payment. The bank authorities stated that they would

> be prepared to approve such bills of exchange as are customarily discounted by them and also good trade bills and

[1] *Ibid.*, August 13, 1914, p. 6377.
[2] *Ibid.*, September 4, 1914, p. 6991.
[3] *Ibid.*, September 30, 1914, p. 7665.
[4] Withers: *War and Lombard Street*, p. 63.
[5] *The Times*, August 13, 1914.

> the acceptances of such foreign and colonial firms and bank agencies as are established in Great Britain

at interest 2 per cent above the varying bank rate. This remarkable provision did give the results expected. On September 5 the bank announced that it would now lend money to acceptors to meet their bills and thus relieve both acceptors and endorsers of bills. Likewise the acceptors were to accept any first charge in favor of the holders of such bills as may have been drawn since August 4. The bank also agreed to make no claim for repayment until a year after the war.

> In order to facilitate fresh business and the movement of produce and merchandise from and to all parts of the world, the joint stock banks have arranged, with the cooperation, if necessary, of the Bank of England and the government, to advance to clients the amounts necessary to pay their acceptances at maturity where the funds have not been provided in due time by the clients of the acceptors. The acceptor would have to satisfy the joint stock banks or the Bank of England both as to the nature of the transaction and as to the reason why the money is not forthcoming from the client. These advances would be on the same terms as regards interest as the premoratorium bill advances.[1]

The provision of the plans to maintain exchange and to lessen the inertia into which the sale of bills had fallen was revolutionary in English finance, but it seemingly accomplished its result due to its adequacy and boldness. For a small interest of 2 per cent the bills of acceptors were practically insured. Of the 7 per cent charged 2½ went to the government, 4 per cent to bank as interest and ½ per cent as commission. The Chancellor of the Exchequer stated that the total amount of bills discounted on the government guarantees was £120,000,000.[2] In reply to a question asked regarding the amount advanced by the Treasury to firms in London in order to meet their obligations in the early days of the war, the Chancellor of the Exchequer stated that the

[1] *The Times*, September 30, 1914.
[2] *Parliamentary Debates*, H. C., November 27, 1914.

total was about £200,000,000 and the amount outstanding on November 31, 1915, was about £25,500,000.[1] The moratorium came to an end November 4, 1914, though the banks had really ended it, so far as they were concerned, in September.

[1] *Parliamentary Debates,* H. C., December 22, 1915.

CHAPTER II

Additional Emergency Measures

The government measures yet to be considered in meeting the financial situation at the opening of the war are the Currency and Bank Notes Act, the restoration of the stock exchange, the Courts Emergency Act and the Shipping Insurance Act. While the last of these is not distinctly financial in character in its larger phases, yet it required Treasury regulation and financial provisions to carry out.

The Currency Situation

It must be said in justice to the English public that there was no great evidence of a lack of confidence in the ability of the nation to maintain its financial status at the opening of the war. On July 29, the Bank of England lost £1,213,000 in gold to the provinces and an additional sum of £8,211,000 in the week ending August 4. There was some hoarding by the banks, for the gold reserve of the Bank of England was reduced from £26,875,194 to £9,966,649. With the extension of the Bank Holidays and the steadily enlarging scope of the moratorium the public became more interested in the prospect of a money famine and began to hoard coin and notes. Some of the banks had already set the example and a run on the joint stock banks became at least prospective.

These institutions were in a difficult position. Their assets were unavailable insofar as they were in the form of short term bills and they did not feel that it was wise to pay out gold. The situation could have been met without much difficulty if the government had had on hand an emergency currency.

> The fleet was ready, and the expeditionary force was ready. The financial machinery was not. Part of the machinery

> was a supply of notes to take the place of our gold currency, if the evil disease of hoarding should break forth, as was likely. Consequently, whether the evil was met by a suspension of the Bank Act, or by an issue of government notes, a supply of £1 and 10s. notes ought to have been in existence.[1]

The banks were apprehensive about the situation and the government took immediate steps to protect them by three important measures which were the general moratorium, the Currency and Bank Notes Act of August 6, and the issue of £1 and 10s. currency notes. The act of August 6 authorized the Treasury to suspend the Bank Act if necessary.[2] This was not done, since the government undertook to do what the act authorized the Bank of England to do. The apprehension which confronted the banks was that there might be a run on their deposits, and because they would not have a sufficient legal tender they could not meet the demands that might be made on them. It was therefore considered necessary that the Treasury should issue £1 and 10s. legal tender notes. To meet the needs of the interval between August 6 and the printing of the notes, postal orders were made current and legal tender in the United Kingdom for the payment of any amount. It was further provided that the postal orders should be redeemable at the Bank of England in any coin which is legal tender. The banks of issue in Scotland and Ireland were permitted to pay their notes in notes of this issue as well as to withhold payment on their own notes except at head offices.

A memorandum of the Treasury immediately followed the act in which it was explained how the notes were to be placed in circulation. As the notes were issued as temporary relief for the banks the Bank of England acted as the agency, and then the Treasury issued the notes to the banks up to a maximum limit of 20 per cent of liabilities on deposit and current accounts. The security for the Treasury was a floating charge upon the bank assets superior to all other claims and bearing interest at the

[1] Withers: *War and Lombard Street*, p. 32.
[2] *London Gazette*, August 6, 1914.

current bank rate. The amounts taken by the banks were comparatively small, £13,000,000, against a possible maximum of £225,000,000. At the end of the period June 9, 1915, the amount outstanding was reported by the Chancellor of the Exchequer as only £139,000.[1]

The issue of these notes was an experiment in English finance. Issued as a temporary means to meet an unusual situation, they have nevertheless remained in circulation during the entire course of the war and have steadily increased in amount. As a means to the rapid restoration of confidence among the banks these notes were exceptionally effective, but they have come to be relied upon by the government for assistance in bridging over financial difficulties. On August 21, 1914, there were £21,535,065 of notes and certificates outstanding; at the close of the following year, December 29, the amount reported reached £103,125,099, and on November 14, 1917, the total then outstanding was £191,352,528.[2]

The Stock Exchange Problem

At the opening of the war the London stock exchange was flooded with international stocks seeking liquidation at almost any price. The prices fell, affecting the value of stocks held on margin and raising as a consequence, many important issues regarding the purposes of the banks and the general credit of the city. The three danger points in the financial organizations were the banks, the stock exchange, and international exchange. The closing of the stock exchange followed, in order that at least temporarily one of these danger points might be removed. Never before had this been done, but the very effectiveness of communication, the artificial system of purchase on margins and the borrowing on stock collaterals endangered the brokers, the banks and the interests of holders. At the same time the closing of the exchange made it still more difficult for the banks to avail

[1] Speech of Lloyd George, *Parliamentary Debates*, H. C., November 27, 28, 1917.

[2] *London Economist*, November 17, 1917, p. 816.

S. E. closes → banks funds tied

themselves of the resources that they had regarded as quick assets.

The situation might have been much worse than it was if the preceding years had not reduced most stock speculators to more or less cautious individuals. Fortunately the stock exchange borrowings were at a low point, comparatively speaking, though it was stated by the Chancellor of the Exchequer that the amount outstanding was between £80,000,000 and £90,000,000.[1] But outside of the actual dealers, the banks had loaned on stock exchange securities as collateral an amount placed as high as £250,000,000. The banks were practically helpless so far as concerned the pressing of their claims for payment. Lower prices would have resulted and if the stock exchange had continued open, the enemy would have sold his securities on the exchange. The effect, too, upon the government's loan policy would have been reflected in the greater difficulty of getting satisfactory prices for its offerings.

The closing of the exchange was a foregone conclusion and its opening a matter of government policy. After five months of quiescence, the exchange resumed business January 4, 1915. The restrictions imposed by the Treasury were severe, varying from hours of business to fixed prices for sales. The exchange was opened between 10.45 and 3.00 o'clock, all sales were for cash, options and arbitrage transactions forbidden, no sales were allowed below the prices fixed and the exchange was not permitted to deal in issues, unless specifically approved by the Treasury, that were offered to the public after January 4, 1915. In order to prevent the sale of enemy securities a good delivery must contain a certification that the securities had not been in the hands of the enemy prior to September 30, 1914. All of these provisions had to do with the opening of the exchange and offered no relief for the harassed brokers and banks. Before the exchange could open it was necessary to provide some means to meet this situation.

[1] Speech of Lloyd George, *Parliamentary Debates*, H. C., November 27, 1914.

The mid-August settlement was postponed until November 18 and practically completed on the following day. A free market was a political impossibility, while the interest of the banks and the members of the exchange pointed strongly to the wisdom of closing. The difficulties of closing were somewhat diminished by the possibility of applying to the stock exchange the principle developed by the government in meeting the problems of international exchange.[1] Matters dragged on until October 31, before the Treasury announced its plan of dealing with the stock exchange situation. Under this plan the government arranged with the Bank of England

> to advance to lenders to whom the scheme is applicable 60 per cent of the value of the securities at present held by the lenders against any loan which they had outstanding on July 29, 1914, such securities to be value for the purpose of the advance at the making up prices for July 29 settlement.[2]

It was left to the Bank of England to refuse any application with the general government policy in mind to prevent as far as possible the forced realization of securities. To protect the government, both the lender and borrower were made jointly and severally liable to the Bank of England. The time of application was limited to January 31, 1915. Loans under the scheme were to bear 1 per cent interest above the bank rate, with a minimum of 5 per cent in all. Interest was to be paid fortnightly and after the stock exchange was opened at the regular settlement dates. It was also provided that the Bank of England was not to press for repayment of advances made under the scheme until the expiration of twelve months after the conclusion of peace or after the expiry of the Courts Emergency Act of 1914 if that should happen first.

The same provisions were extended to provincial exchanges and to the cotton exchange at Liverpool. In order to gain a clear view of the situation, the Chancellor of the Exchequer, in conference with representatives of the exchanges, called for a

[1] Articles, *London Economist,* August 22 and 29, 1914.
[2] The Stock Exchange Scheme, *London Economist,* November 7, 1914.

statement of loans and asked for the cooperation of the exchanges of the United Kingdom, eighteen in number. In London alone the loans returned under the questionnaire were £81,000,000, while those of the country did not exceed £11,000,000. The full amount was therefore under £92,000,000, of which about £77,000,000 was money upon which adequate cover had been provided for, leaving £15,000,000 unprovided for in this way. This did not represent the full amount for the reason that millions of pounds of stocks and shares standing in the names of exchange men and their clients had been taken over by them for the good interest represented in the transaction.[1] There were 5,000 members of the London exchange. Of this number, probably 90 per cent were doing business on a legitimate scale and the other 10 per cent could be classed as plungers and trouble makers. The government practically overlooked the 90 per cent and frankly looked upon the exchange as a danger point due in part to the transactions of the 10 per cent. The settlement on the 18th of November was regarded in consequence as the most critical which the exchange had faced in a hundred years. In commenting upon the situation, the *London Economist* stated:

> It may be safely said that the settlement has gone through with infinitely more ease than anyone expected ten days or a fortnight ago. . . . But the broad fact remains that the trouble has been faced, and surmounted, in a manner which has left the stock exchange in a position so much sounder than it occupied before that, as already observed, the path to reopening is rendered not only plain, but perfectly possible.[2]

THE COURTS EMERGENCY ACT

The moratorium ended for all debts on November 4, 1914, and on October 4, the moratorium for bills of exchange, debts due to and from retail dealers and rents came to an end. For those who found it difficult to adjust their affairs satisfactorily, the Courts Emergency Act, 1914, provided a way to get at least

[1] *London Economist*, October 17, 1914, p. 634.
[2] *Ibid.*, November 21, 1914, p. 915.

legal opinion concerning the validity of their excuses. This act placed a check on the exercise of creditors' rights generally and gave debtors protection within recognized limits. The creditors, by its provisions, could not proceed to execution or enforcement of a judgment of any court for the payment of a sum of money, nor levy distress for nonpayment of rent where the rent was less than £50 per annum. The act also prohibited the taking possession of property or the reentry to enforce payment of money, or foreclose or realize on any security with the exception of a sale by a mortgage already in possession. Life insurance premiums of £25 or under could not lapse for nonpayment where they had been paid for at least two years prior to August 4, 1914. To protect himself, the creditor was required to make his application to the High Court, Country Court or Court of Summary Jurisdiction. The debtor, in his defense, was required to show that he was unable to pay by reason of circumstances due to the war. The court was then at liberty to determine the best thing to be done under the circumstances. The act did not affect pawnbrokers or alien enemies who were debtors and was to remain in force until six months after the war unless modified or set aside by Order in Council.

> The act is apparently not even limited to liabilities incurred before the war broke out, and is in effect, therefore, a discretionary moratorium of unlimited scope. If the courts interpret the act to mean that debtors are to be treated with the utmost leniency, ordinary commercial relations will be impossible; if they do not allow much latitude the purpose of the act will be defeated. Parliament has merely thrown upon the courts the impossible task of deciding where the line of bankruptcy is to be drawn. Some people will be protected from bankruptcy, others will not, but no one contracting party can know until he tries to enforce his contract whether it is enforceable or not. Possibly the act may work out better in practice than it promises to do on paper, but such a happy result will be due to the presence of a spirit of high commercial morality in the country, rather than to any inherent nature of the act itself.[1]

[1] *London Economist*, October 3, 1914, p. 564.

Shipping Insurance

At the outset of the war, the government recognized the importance of shipping. The rates for war insurance vary from 60 to 70 guineas per hundred for vessels belonging to any of the four continental Powers and 70 to 75 for additional vessels belonging to Austria and Italy; while for Germany and Great Britain alone, the insurance on war risks was 50 guineas per hundred. These rates were based upon certain combinations which the general character of the war negatived and brought corresponding strain upon the marine insurance market which it was unable to stand. The ordinary time policies were subject to exemptions under the seizure, capture and detention clauses, leaving the insurance in view of the new type of warfare distinctly inadequate. The plan developed by the government enabled ship owners to cover war risks from voyage to voyage and at the same time materially affected the market rate of insurance premiums.

The plan was based on the principle of the reinsurance with the state of the insurance of the Lloyd Association. In other periods of war, insurance on shipping has been transferred from indemnities to mutual insurance associations or clubs. The associations in existence were the North of England Protecting and Indemnity Association, the London Group of War Risks Association, and the London and Liverpool War Risks Insurance Association. The total insurance carried in these associations amounted to £87,000,000. This insurance was distinctly limited, since it only covered vessels at sea, or in an enemy's port at time of hostilities until they reached a British port. The provisions were much below the requirements of the situation. The clubs, however, provided a foundation upon which to work.

With this foundation, the government took over the insurance of vessels then on voyage to the extent of 80 per cent, the associations carrying the other 20 per cent. For subsequent voyages the owners were to pay a premium whose maximum was not to be greater than 5 per cent and not lower than 1 per cent. At first the rate was fixed at 1¼ per cent on hulls for single voyages

and 2½ per cent on round voyages. It was decided August 15 that vessels could be insured for three months at a premium of 2½ per cent. At the opening of September the premium on single voyages was reduced to 1 per cent and round voyages to 2 per cent. It was provided that vessels should take orders from the government on routes, calls and stoppages.[1]

A Summary of Emergency Measures

The summary of the emergency provisions enacted by the government would extend to many phases of commercial, financial and political affairs. The more important have been described in the last two chapters. How adequate these are may be better appreciated by enumerating them at the close of this chapter. The rehabilitation of bills of exchange by providing for advances on approved bills, the provision for small currency in the issue of £1 and 10s. notes, the closing of the stock exchange and the loaning of funds on securities, the provision for relief of debtors who were financially disabled by the war and the shipping insurance. In these provisions Great Britain reestablished her foreign exchange and, providing for the movement of her shipping, organized her internal business by providing small notes for circulation and ending the demoralization of securities by closing the stock exchanges.

[1] Description of Plan, Lloyd George, *The Times,* August 5, 1914.

CHAPTER III

The War Budgets

In England the budget is thought of as the speech of the Chancellor of the Exchequer rather than the act of Parliament appropriating the money. This is quite in contrast with the procedure existing in the United States, where there is no budget, and on the continent in Europe, where the budget is viewed as the document setting forth the expenses and the receipts of revenue.

The English Budget Defined

The English budget, on the contrary, forecasts the nature of the revenue or finance act. The English system shows two great funds: the Civil List and the Consolidated Fund. The first really becomes a royal household budget and the second is the fund dealing with the general expenses of the government. The Consolidated Fund supply services consist of the continuing expenditures which are not made by annual vote. These are the costs of maintaining the Army, Navy, Civil Service, and Revenue departments. The first two need no explanation. The civil services include the expenses of maintaining and constructing public works and buildings; (2) salaries and expenses of civil departments; (3) law and justice; (4) education, science, and arts; (5) the foreign colonial service; (6) noneffective and miscellaneous services; (7) old age pensions, labor exchanges, insurance, etc. The revenue departments include those of (1) customs and excise; (2) inland revenue; (3) the post office. The Consolidated Fund stands to the credit of the Exchequer for which the Bank of England, and the Bank of Ireland are the custodians. In Scotland the custodianship is passed around from year to year among six banks. These funds are administered through the Treasury in which the British Government

has a great organ of general control, but in no sense is it a public service department, for it does not come in contact with the public and does not collect the public funds, that service being carried on by the Custom, Excise and Inland Revenue departments. It is to this great department of government (the Treasury) that Parliament and the public look for wise and economical administration.

The First War Budget

From the date of the opening of the war to April 30, 1918, four great budgets have been presented by three Chancellors of the Exchequer. The peace budget for the year 1914-15 was left standing as it was when introduced May, 1914. Using this as a basis the first war budget providing for increase of taxation was introduced November 16, 1914, for the period ending March 31, 1915. The second war budget was introduced September 21, 1915; the third, April 7, 1916; and the fourth, May 2, 1917. The normal budget requirements of the last peace year are set forth in the following table:

ESTIMATED NORMAL EXPENDITURE, 1914-15

1. Consolidated Fund services		
National debt services		
Interest and management		£16,741,000
Repayment of capital		6,759,000
Total national debt services		£23,500,000
Road Improvement Fund		1,545,000
Payments to local taxation accounts, etc		9,885,000
Other Consolidated Fund services		1,706,000
Total Consolidated Fund services		£36,636,000
2. Supply services		
Army (including ordnance factories)		£ 28,885,000
Navy		51,550,000
Civil services	£58,902,000	
Deduct difference between supplementary estimates allowed for and those actually presented	17,000	58,885,000
Customs and Excise and Inland Revenue departments	£ 4,821,000	
Deduct supplementary estimate not presented	80,000	4,741,000
Post office services		26,227,000
Total supply services		£170,288,000
Total expenditure		£206,924,000

To offset these estimates the Chancellor estimated a total revenue, slightly larger, at £207,146,000.

ESTIMATED NORMAL REVENUE, 1914-15[1]

Customs and excise	£ 75,350,000
Inland revenue	96,016,000
Total receipts from taxes	£171,366,000
Post office services	£ 31,750,000
Crown lands	530,000
Receipts from Suez Canal shares and sundry loans	1,370,000
Miscellaneous	2,130,000
Total receipts from nontax revenue	£ 35,780,000
Total revenue	£207,146,000

Before the last peace year closed there was a drop of £11,350,000 in income, so that the Treasury faced a deficit of nearly that sum when March 31, 1914, was reached. Consequently, when Lloyd George presented the first budget to Parliament in November, he had to take care of nearly £12,000,000 left over from the previous year in addition to the new burdens the war had thrust upon the Treasury.[2] His previous budget contained many provisions for social reforms and the outlook as measured by the returns promised well for the new proposals of the Chancellor. The war shattered these hopes, reduced probable revenue and emphasized the necessity of a new statement and an early acceptance of more radical taxation, not for reform but for war purposes.

The Chancellor prepared his auditors for the heavy hand of war expenditure by reciting the fact that the highest cost of war in the past for a single year was £71,000,000. The estimate for the first year of this war was placed at £450,000,000, a sum too large to raise by taxation, though in 1917-18 the revenue from taxation reached £613,000,000. Continuing, he stated the French wars had cost £831,000,000, of which £440,000,000 were raised by taxation. The national income of the country in Pitt's day was estimated at £250,000,000 and was now placed at £2,300,000,000. He therefore urged that as much as possible

[1] Lawson: *British War Finance*, 1914-15, pp. 288-289.
[2] *Parliamentary Debates*, H. C., November 17, 1914.

should be provided by taxation, expressing the hope that the war will bring a great reduction in armaments when it is concluded and the world gets around to survey the havoc done. He informed the House that the pension list would be increased by £10,000,000 annually and he assured members that even under the circumstances the government would levy no taxes that would interfere with productive industries.

This was the spirit in which the Chancellor approached the problem of war finance. His first proposal was to double the income tax then standing at 9d. Unearned income was to pay one-forty-eighth for this year and one-sixteenth next year. The double tax, however, only fell on the tax payers for one-third of the year, December 1, 1914, to April 1, 1915, which meant one shilling on the 9d. class and 1s. 8d. for the rest. The Inland Revenue Department under this provision expected to collect £11,000,000 of additional income tax, and £15,000,000 under the supertax. Next year, 1915-16, the income tax was expected to produce £38,750,000 and the supertax £6,000,000 additional, an increase of £44,000,000.

The Chancellor approached the problem of indirect taxes with less confidence. These, he said, were always borne unequally and presented fiscal problems of great difficulty. He passed by a tax on wages, though it practically became a war measure later on when the income tax exemption was lowered, but beer, tea and tobacco did represent possible sources of income that could not be overlooked in a national emergency. The state of the beer trade was not all that could be asked and some concessions in license fees should be made to affect the reduction in hours of business caused by war orders and the Scottish Temperance Act. If they were given a concession of one-fifteenth of the license for every hour of reduced business time down to one-fourth of the license payment, the cost to the government would be £450,000 in lessened income the first year and £550,000 the following year. If beer were charged on a spirit basis, the tax would amount to 27s. 10d. per barrel, but the tax was only 7s. 9d. It was necessary, however, to phrase the tax in such a way as to permit it

to be passed on to the consumer, and this could be done by making it ½d. on the one-half pint or 17s. 3d. per barrel. Taking into consideration the license concessions, the returns from the beer tax for the remainder of the year should bring £2,050,000 and next year £17,050,000.

Somewhat facetiously, the Chancellor proposed the tax on tea under the caption of "Catching the Teetotaler," [1] a bad pun that had its soporific effect nevertheless. He didn't think there could be a graduated scale on the basis of quality, and he therefore proposed a straight increase of 3d. on the pound over the 5d. tax that had prevailed since the reduction from 6d. to 5d. after the Boer War. He hoped to get £950,000 for the year and £3,200,000 for the following year. The tax on whiskies and wines remained as before, since it had produced but little revenue the previous year and an added tax was "bad for the trade." Tobacco was permitted to stand as it was.

The first war budget was grafted on a peace budget and the remarkable thing about it was that it did not include a single new tax. The proposed expenditures were to reach £532,617,000 with a revenue of £211,296,000, leaving £321,321,000 to be borrowed. The situation thus stood:

ESTIMATED REVENUE, 1914-15 [2]

Customs and excise		£ 71,350,000	
Add			
Additional tea duty	£ 950,000		
Additional beer duty	2,500,000		
	£3,450,000		
Less			
License duty	450,000	3,000,000	£ 74,350,000
Inland revenue		£ 89,016,000	
Add			
Proposed increase of income tax and super-tax		12,500,000	101,516,000
Total receipts from taxes			£175,866,000
Total receipts from nontax revenue			35,430,000
Total estimated revenue			£211,296,000
Deficit to be made good by borrowing			321,321,000
			£532,617,000

[1] For the discussion of these points see speech of Lloyd George, *Parliamentary Debates*, H. C., November 17, 1914.

[2] Lawson: *British War Finance*, 1914-15, pp. 291 and 292.

Other features of the budget such as loan policy annuities and sinking fund will be left for consideration in the chapter on loans. It is worth while to give brief consideration to contemporaneous opinion on this war budget. *The Economist* said it was a budget of no nonsense.[1]

> There is no dodging, no attempt to impose taxes which will be profitable to certain interests, and therefore popular with a section of the country. We are inclined to think that the simplicity of this budget has a massive merit to which a more refined and elaborate scheme could not pretend.

With a somewhat more critical view, Mr. W. R. Lawson, a well known financial writer, said,

> It, the House of Commons, has practically shut its eyes to the terrific expenditure that is going on, and weakly accepts the Chancellor's allusions to the millions on millions that will have to one day be provided by the tax payers.[2]

How far the consensus of opinion was from the actual cost of the war is well shown by the statement that it would take a billion pounds to finance this war.[3]

Tested by the actual figures for the year, this budget conformed more nearly to the estimate than any of the war budgets, with the possible exception of the McKenna budget. The total receipts were £227,590,000, necessitating votes of credit to the extent of £357,000,000 or about £36,000,000 more than the Chancellor regarded as necessary.[4]

The Second War Budget

When Lloyd George presented his second financial statement, May 4, 1915, leading to the more elaborate considerations of the budget requirements later on, it was no longer possible to distinguish between ordinary peace expenditure and expenditure upon the war. The cost of army and navy was to be carried by

[1] *London Economist,* November 21, 1914, p. 907.
[2] Lawson: *British War Finance,* p. 274.
[3] *London Economist,* November 16, 1914.
[4] Revenue and Expenditure, White Paper, H. C., No. 309, July 23, 1915.

votes of credit. On the assumption that there was to be six months more of war, the total expense would approach £800,000,000, if it continued for a year the cost would go to £1,136,434,000, which, if reduced by tax income would leave £862,322,000 to be financed by borrowing. The returns from taxation showed wonderful buoyancy. The full yield of the income tax attributable to 1914 was £47,000,000, but this under the new taxes of November was expected to realize £53,000,000, but actually brought £59,270,000. The same story held for other taxes. The supertax brought nearly £2,000,000 more than was estimated and the number of payers increased to 12,000 with a probability of going to 15,000. The customs and excise brought £95,270,000, or an increase of £13,675,000 over the receipts of the previous year. Land value duties brought in but £350,000. The total tax revenue in consequence went to £235,700,000 and the total nontax revenue amounted to £34,632,000 or a total revenue of £270,332,000. By suspending the sinking fund payment for the year to the sum of £3,780,000 and deducting the advances made to the Allies and Dominions, in amount £52,370,000, the cost of the war for an additional year would be £1,132,654,000 or £2,100,000 per day.[1]

A change of view regarding the cost of war rapidly gained headway not only as to the burden but as to the methods of financing the war. The Chancellor of the Exchequer was evidently satisfied to let the taxes of the previous November stand as the basis for the revenue of the year and as the budget stood in May, 1915, it was the purpose to let the rates then proposed stand for the next year of the war.

The Third War Budget

In June, 1915, Lloyd George was succeeded as Chancellor of the Exchequer and the energetic Commoner became Minister of Munitions, where his great administrative ability showed more brilliantly than it had in his second budget. The new Chan-

[1] For statements in this paragraph see *The Times*, May 5, 1915.

cellor, McKenna, commenting upon the war cost the last of June showed that the war expense had risen to £3,000,000 per day.[1]

> The main observations we would make, are (1) that the new taxation (which was overdue, as shown by Mr. Lloyd George's financial statement at the beginning of May) is still overdue, and (2) that economy in the widest sense, public and private, has not been passed from talk into action.[2]

And the same journal in commenting on the only real advance made in taxation, that proposed by Mr. McKenna in the following September, said, "The present war budget is belated, but not inadequate." [3]

It is an historic and picturesque scene which *The Times* presents in the following paragraphs:

> The floor of the House of Commons was crowded for the Chancellor of the Exchequer's budget this afternoon, and members overflowed into the galleries. Two former Chancellors of the Exchequer—Mr. Asquith and Mr. Chamberlain—were present to hear Mr. McKenna's momentous proposals, but Mr. Lloyd George was absent. There was a large attendance of peers in their gallery, and the public gallery also was quite full. Mr. McKenna, who rose at a quarter to four, was able, without haste and without lack of precision, to pack his businesslike speech within 75 minutes; and when he resumed his seat, congratulations which were addressed to him were based as much upon his lucidity as upon his brevity. The speech, in fact, was an orderly procession of intelligible and almost expected figures.
>
> The revised estimates for the current year put the revenue, on the basis of existing taxation, at £272,110,000 and the expenditure at £1,590,000 and the dead weight of debt at the close of this year would be £2,200,000,000—including advances to our allies which would be repaid. "There is no record," said Mr. McKenna, "of a nation having voluntarily accepted liabilities bearing so high a proportion to the total national income for which provision is to be made within a single year." Without undue delay he proceeded

[1] *The Times*, July 3, 1915.
[2] *London Economist*, July 26, 1915, p. 123.
[3] *Ibid.*, September 25, 1915.

> to describe the measures which are to be taken to provide £107,000,000 by new taxation. The income tax is to be increased by 40 per cent, the exemption limit is to be reduced from £160 to £130, and the abatements from £160 to £120 and from £150 and £120 to £100. The assessment under Schedule B is to be taken as the rent paid instead of as one-third. Payment of income tax will be accepted in certain cases in instalments.[1]

Mr. Lloyd George's budget was based upon the supposition that there would be £1,152,654,000 to raise and relying upon the taxes already imposed he added two additions of votes on wines and beers calculated to produce £3,000,000. A new survey of the situation in September caused Mr. McKenna to startle the House by telling it there was £1,590,000,000 to find for the fiscal year. It has already been shown that he proposed an increase of the income tax by 40 per cent and the exemption lowered to £130. But in addition there was to be a special tax on war profits of 50 per cent, an increase of 50 per cent of the duties on tea, tobacco, cocoa, coffee, chicory, and dried fruits and on motor spirits and patent medicines of 100 per cent. The old halfpenny postage and six penny telegrams were abolished and an increase in letter, parcels, telephone and telegraphic charges recommended. From these new sources he hoped to get an addition of £32,904,-000, which, added to the existing basis of taxation, provided an income of £272,110,000 and a total of £305,014,000.

When the national balance sheet of the year was struck the financial statement appears as follows:

Navy	£190,000,000	
Army	715,000,000	
External advances	423,000,000	
Pre and post moratorium bills	36,000,000	
Ordinary national services	170,000,000	
Food supplies, minor items and contingencies	56,000,000	£1,590,000,000
Revenue Same Period		
On existing basis of taxation	£272,110,000	
New taxation	30,924,000	
Revenue from postal charges	1,980,000	305,014,000
Estimated deficit		£1,285,014,000

[1] *The Times,* September 22, 1915.

Great as was this deficit there was to be added to it the deficit from last March amounting to £334,000,000 and also the previous debt of £651,000,000 so that the net dead weight of national indebtedness would stand at £2,200,000,000 April 1, 1916. In the face of such sums the surprise of the budget was the comparatively small amount of new taxation. While the total yield of taxes eventually involved heavy sacrifices it did not fall upon the tax payer until the following year. There was some basis for the remarks of Earl St. Aldwyne when he replied to criticisms of the budget that the bill should have gone farther, by saying,

> More indirect taxes should have been levied and the government was to be criticized in the delay in imposing new taxes. The government was always too late in their actions.[1]

The budget for the year ended March 31, 1916, was remarkable in one respect, at least, for it was the only one of the war budgets that actually came within the figures submitted, since the expenses were £31,000,000 less than the estimated amount. This fortunate result was more apparent than real for it was expected that £423,000,000 would be advanced to the Allies and Dominions, and only £316,000,000 were so spent. When it came to the new year, the Chancellor's statement called for a total of £1,825,000,000 or £350,000,000 more than the year before. This sum on a day basis moved the cost to an even £5,000,000. The war service was to cost £1,120,000,000, miscellaneous service, £30,000,000, advances to Allies and Dominions, £450,000,000, the Consolidated Fund services, interest on the public debt, and incidentals connected therewith, £138,500,000, the Civil Service £60,000,000, and the post office £27,000,000. From the excess profits tax it was hoped that there would be £86,000,000 and other taxation would bring £423,000,000. In these figures was an increase of £93,000,000 over the tax returns of the previous year, making ample provision for interest on debt and sinking fund.

[1] *Parliamentary Debates,* H. C., December 21, 1915.

The new tax proposals called for a change in the rate on incomes varying from 1s. 6d. to 5s. on incomes exceeding £2,500. Amusements, railway tickets, matches, mineral water, motor cars and cycles, and motor spirits in addition to added taxes on sugar, cocoa, coffee, and excess profits formed part of the revenue plans of the new budget. Many of the defects in the excess profits tax were corrected and the rate raised to 60 per cent. There was no attempt in the budget to prevent consumption of luxuries. The results from the taxes laid by this budget were expected to produce the results shown in the table below:

Income tax additions	£ 45,000,000
Excess profits	86,000,000
Amusements tax	5,000,000
Railway tickets tax	3,000,000
Sugar tax additions	7,000,000
Coffee, cocoa, chicory	1,650,000
Matches tax	2,000,000
Mineral waters, cider and motor cars and cycles	860,000
	£150,510,000

The comments on this budget were more favorable than those made on its predecessors. "It was a budget of honest workmanship," says one;[1] "Will it cause sacrifice to be transferred from rhetoric to action?" says another. A representative from Ireland protests against the budget from beginning to end as related to Ireland holding that Ireland because of its spirit manufacture was indefensibly taxed,[2] while others thought there should have been heavier taxation on large incomes. "It is, however, the first time the income tax has been extended downward to wage earners," declared *The Times.*[3]

The Fourth War Budget

Without question, the McKenna budget was the greatest of the four war budgets up to April, 1918. Before he was called upon to present another one the ministry was changed and Bonar Law succeeded to the portfolio of the Treasury. The attitude of this

[1] F. W. Hirst, *London Economist,* April 8, 1916.
[2] *The Times,* April 5, 1916.
[3] *Ibid.,* April 6, 1916.

Chancellor has been distinctly a borrowing policy, to rely upon the taxes as they stood and finance the war with votes of credit and extended borrowing. His recommendations for added taxes were almost negligible.

> In the face of extravagance and inflation the only cure was surely taxation or compulsory borrowing which alone could have taken out of the hands of thoughtless and ignorant people the power to warp the economic energy of the country from the war work on which it should be concentrated.[1]

Despite this and other comments, though the added provisions were slight, the budget added £27,000,000 in new taxation by an increase of 1s. 10d. on tobacco, added rates on amusement tickets and the increase of the excess profits tax to 80 per cent. Against the increase was a loss of £900,000 through rebates on liquor license duties, leaving the net increase £26,100,000. The Chancellor therefore expected to get £543,600,000 from taxation and £68,900,000 from additional war revenue making the revenue for the year £638,600,000. On the expense side the national debt service was to cost £211,500,000 and the other Consolidated Fund services £11,335,000. The total of the supply services were estimated at £92,486,000. Added to the cost of conducting the war £1,975,000,000, the total of the year reached £2,290,-381,000. When the revenue is deducted from this vast sum there was left to be raised £1,651,400,000. These are enormous figures, but there was hardly a ripple in financial circles when they were made public.

> Budget Day passed off very quietly. There was little lobby comment on the speech, beyond a general feeling of satisfaction at a negative feature of the budget, the decision to make no change in the income tax. The view was mostly taken at this stage of the war that a stationary income tax was a sign of national strength.[2]

It did not seem desirable to the Chancellor after considering the difficulties of setting up new machinery for collection to levy

[1] *London Economist,* May 5, 1917, p. 768.
[2] *The Times,* May 3, 1917.

new taxes. The policy of adding enough to compensate for new changes arising from the new borrowings was enough for this year.[1] The predecessor of Mr. Bonar Law in the debate expressed himself as fearing that it would be as far behind actual expenditures as was the last budget.

Estimates, Revenues and Public Debt

As an actual fact the budget produced £68,000,000 beyond the estimate made at the opening of the fiscal year and £134,000,000 more than the budget of 1916-17. The tax revenue reached £613,000,000, or £99,000,000 more than in the previous year. The situation is shown in the following table.

Customs	£ 71,261,000
Excise	38,772,000
Estate duties	31,674,000
Stamps	8,300,000
Land tax and house duty	2,625,000
Income and supertax	239,509,000
Excess profits	220,214,000
	£612,355,000

The post office, crown lands, sundry loans and miscellaneous items produced an additional £94,879,565, making the total revenue for the year £707,234,565. Taking the tax revenues for the four financial years April 1, 1914, to April 1, 1918, there is an amount including arrears of possibly £200,000,000, a tax income of £1,800,000,000, which, with income from other sources, brings the total of income for the above mentioned period to £2,100,000,000. Confining the time to the war period alone, the total aggregate revenue received amounts to £1,789,000,000 of which £1,543,000,000 was from taxes. The total expenses during the war period, August 1, 1914, to April 1, 1918, were £6,961,000,000. From this sum certain assets in the form of advances to Allies and Dominions, munition plants, shipping, etc., have been deducted by the Chancellor, leaving the amount at £5,000,000,000. If this is the case, 40 per cent of the war cost to Great Britain has been paid from revenue and 35 per

[1] *Parliamentary Debates,* H. C., vol. 105, May 2, 1917.

cent from taxes.[1] In this estimate, however, an allowance of nearly £300,000,000 is made for taxes in arrears, and deductions of generous amounts for payments to Allies and Dominions are taken from the total expenditure. It is difficult in view of the many factors involved to reduce payments to a percentage that means very much. If the advances to Allies and Dominions are retained as a part of the war cost so far as Great Britain is concerned, the actual amount raised by taxation is practically one-fourth of the amount expended during the war.

[1] *The Times*, April 2, 1918.

CHAPTER IV

Votes of Credit and the Cost of the War

The theory upon which the budget practice of the House of Commons is based contemplates the review of all the transactions of the Treasury. This was a precious heritage of the Commons and one gained through long years of adherence to the principle of its financial responsibility. The war, however, with the requirements of secrecy and inability to foretell the cost, has broken down this principle of review and substituted for it the vote of credit. It was necessary in August of 1914 to place a large sum at the disposal of the government and this was done in the enactment of the first vote of credit for £100,000,000. So averse were the Lords of the Treasury to this action that they issued an apology in the form of a minute which emphasized the necessity of " procedure by way of supplementary estimate rather than by vote of credit." [1] This view had been forcibly stated on February 14, 1880, in a resolution by the same body to the effect that

> Whenever practicable, a war not provided for in ordinary estimates should be provided for by supplementary estimates for the army or navy, as the case may be, and not by vote of credit.

With this bit of history before them the Lords of the Treasury nevertheless felt themselves justified in view of the emergency to set up again the method of the vote of credit and to draw the resolution in the " mildest terms " when they came to meet the problem at the opening of the war. In previous instances prior to 1880 the votes of this character rarely exceeded £5,000,000, but now the Commons had by one act given the right of expenditure over £100,000,000 without any estimate of its ex-

[1] Treasury Minute, p. 2, August 20, 1914.

penditure. So impressed was the Commons with the wisdom of this view that in the War Loan Act it gave to His Majesty the power "to raise money in such manner as the Treasury may think fit[1] and for that purpose they may create and issue any securities, etc."

The Vote of Credit Described

In the resolution of February 14, 1880, the vote of credit is described in this way: "The House of Commons, in fact, dispenses for the time with its power of control, and grants a sum of money in gross, and without the usual limitations to the Treasury as being the central department of finance, to which it leaves the responsibility of distributing the money in the manner best calculated to meet the emergency." It is too much to say, however, that the government during this war has given Parliament no inkling of the use of money. Excluding the first vote the Prime Minister or the Chancellor of the Exchequer has presented to the House an elaborate review of the expenses of the war and the progress of expense by reducing the amounts needed to a day basis for easy comparison. The detail of expenditure under normal conditions however, has been omitted from these statements, and the House has not been able to control the designation of amounts to war purposes, thus nullifying one of the fundamental features of the English financial system,

> that no appropriation shall be made except in pursuance of a formal estimate submitted on behalf of the Crown, that individual members have not the right to propose expenditures or even to move the increase of the proposals of the Crown.[2]

Votes of Credit, 1914-1918

The extent to which the vote of credit has been carried as the means of securing authority for the financial conduct of the war is only realizable when the full facts have been clearly grasped.

[1] War Loan Act, 1914, 5 George V, chap. ii.
[2] Willoughby: *Financial Administration of Great Britain*, p. 119.

Beginning with a vote of £100,000,000 on August 6, 1914, the amounts reached as high as £650,000,000 on July 25, 1917. For the eight months ending March 31, 1915, the total of votes for that period were £362,000,000. In 1915-16 the votes amounted to £1,420,000,000, reaching £2,010,000,000 in the fiscal year 1916-17 and touching £2,800,000,000 or many millions beyond this last amount, in the fiscal year closing March 31, 1918. The total of these votes, including the last one of £550,000,000 on December 13, 1917, is £6,592,000,000.

VOTES OF CREDIT, AUGUST, 1914, TO DECEMBER 31, 1917

1914-15	
1. August 6	£100,000,000
2. November 15	225,000,000
3. March 1	37,000,000
	£362,000,000
1915-16	
4. March 1 [1]	£ 250,000,000
5. June 16	250,000,000
6. July 20	150,000,000
7. September 15	250,000,000
8. November 10	400,000,000
9. February 22	120,000,000
	£1,420,000,000
1916-17	
10. February 22 [2]	£ 300,000,000
11. May 23	300,000,000
12. July 24	450,000,000
13. October 11	300,000,000
14. December 16	400,000,000
15. February 13	200,000,000
16. March 16	60,000,000
	£2,010,000,000
1917-18	
17. February 13 [3]	£ 350,000,000
18. May 10	500,000,000
19. July 25	650,000,000
20. September 23	350,000,000
21. October 31	400,000,000
22. December 13	550,000,000
	£2,800,000,000
Summary	
1914-15	£ 362,000,000
1915-16	1,420,000,000
1916-17	2,010,000,000
1917-18	2,800,000,000
	£6,592,000,000

[1] Available, April 1, 1915.
[2] Available, April 1, 1916.
[3] Available, April 1, 1917.

This enormous sum represents practically the war and government cost during the period since 1914. The sum has been secured by (1) taxation, (2) from nontaxable income and (3) by loans. The cost of government before the opening of the war was approximately £200,000,000 annually, so that there is chargeable to that expense the sum of £683,000,000, leaving the outlay for war £6,218,000,000 up to April 1, 1918. The revenue for the same period was £1,789,000,000 of which £1,592,000,000 was from taxation as shown by the table below:

REVENUE FROM TAXATION [1]

From August 1, 1914, to March 31, 1915	£ 172,159,000
From April 1, 1915, to March 31, 1916	290,873,000
From April 1, 1916, to March 31, 1917	516,513,000
From April 1, 1917, to April 1, 1918	613,000,000
	£1,592,545,000

The process of subtracting the tax income and the additional nontax revenue from the total of war expense and government expenditure leaves £5,172,000,000 to be raised by loans. It has been customary to deduct the advances to the Allies and the Dominions from the aggregate of the war debt. If this is done the total left is approximately £3,625,000,000.

Average Daily Costs of the War

Each vote of credit has been a disappointment, for the estimates of the Chancellors have been exceeded by the rising cost of war. When Premier Asquith presented his estimate on November 17, 1914, he stated the cost was then estimated at £900,000 to £1,000,000 per day; speaking less than four months later he said, " the war cost for the 240 days then ending had been at the rate of £1,500,000 per day." [2] On June 15, 1915, the Premier in asking for the fifth vote of credit found it necessary to raise the estimated cost to £3,000,000 per day. So rapid were

[1] Revenue and Expenditure, H. C., White Papers, No. 134 (1915), 119 (1916), 134 (1917).

[2] *The Times,* March 2, 1915.

these increases that the Prime Minister suggested £5,000,000 as the probable cost and one that might be regarded as a safe estimate.[1] The future requests were based upon this assumption, for it was expected that the vote of £300,000,000 on February 22, 1916, would last 60 days. At that time the Chancellor stated that the debt service alone was requiring £500,000 a day. By October 27, 1916, the old vote of credit was exhausted, indicating the passing of the £5,000,000 per day cost and the last of the year the daily cost was slightly over £5,700,000.

When the vote of credit was asked July 25, 1917, the Chancellor was faced by a pessimistic House due to the excess of war costs over the budget estimates. The daily expenditures at that time were stated to be £6,795,000 for the previous 112 days. The budget estimate was £5,411,000, which left an excess over the budget of £1,384,000 per day or £155,000,000 for the period. The explanation offered by the Chancellor called attention to the heavy advances to Allies and Dominions now amounting to £1,461,000,000. In the 112 days under discussion, the Allies and Dominions had received £197,000,000. The expenses at home had increased nearly £100,000,000. In the debate that followed, Mr. McKenna said, "that in his opinion the country must look forward to an expenditure of £8,000,000 per day." The Chancellor, Bonar Law, was so impressed with the situation that he made an admission that was received with surprise. His statement was as follows:

> That acting on the basis of a joint campaign, the United Kingdom had borne the whole expense of the Allies for purchases in Great Britain. It is an open secret that the resources available for payments in America were about exhausted when America entered the war. Although they could not continue to expend at the present rate they could do so longer than their enemies.[2]

The vote on this day was the largest in the history of the war. The vote just prior to this one was for £500,000,000, but the

[1] *The Times*, September 16, 1915.
[2] *Ibid.*, July 25, 1917.

Chancellor asked for £650,000,000, stating that the amount would carry the war to the last of October. The request for so large an amount brought criticisms and suggestions for smaller votes. The pressure of time stood in the way of this request, since the preparation of the material and passage of the vote required fifteen days. Nevertheless the next vote, October 31, was for the amount of £400,000,000 and the one on December 13, for the period to March 31, 1918, was for £550,000,000, making the total vote of credit for this fiscal year, £2,800,000,000. The expenditures of the first six months of the year were £1,237,000 a day more than the Chancellor had estimated. In his explanation of the difference by the use of amounts paid to the Allies, the purchase money used to buy supplies, ships and materials, he was able to reduce the amount to a deficit of £239,000 per day.[1] The Chancellor made no proposal to introduce an interim budget and upheld his position and that of the nation by comparisons with the deplorable condition of German finances.

In moving the new vote of credit December 13, 1917, the Chancellor showed that the previous vote would last as long as calculated, to January 9, 1918. The rate of deficit growth up to December 1 is somewhat larger than the previous period. On the date given above, the cost per day will amount to £6,794,000 or £1,383,000 per day in excess of the budget. This showing appears to give a wrong impression of the financial strength of the country if no account is taken of the offsets against the deficit. Up to December 1, 1917, the budget deficit for the year amounts to £309,000,000. There were £79,000,000 in advances to the Allies over the budget estimate, payments to Dominions, £27,000,000, purchases of supplies and food amount to £89,750,000, and balances in the hands of agents bring these credits to £225,000,000, thus reducing the budget deficit to £350,000 per day instead of £1,275,000.[2] The Chancellor then went on to explain the dead weight charges amounting to £84,000,000.

[1] *The Times,* October 31, 1917.
[2] *Parliamentary Debates,* H. C., December 2, 1917.

This sum was spent for increase in the aviation program, for Indian troops in Mesopotamia and for miscellaneous services, and the results obtained by the expedition in France and Palestine were such as to cause tax payers to face increased expenditures with equanimity.

The last speech of Mr. Bonar Law, March 7, 1918, presented the facts of expenditure upon his request for a vote of credit to begin the new fiscal year. From his analysis the daily costs show some decline, but not a material one. He placed the daily cost at £6,750,000, and in consequence stated confidently that he expected the vote of £600,000,000 which he was asking to begin the year to last until June. From December 1, to February 9, 1918, the daily cost averaged £6,107,000. The expenditures for the year up to February exceeded the budget allowance by the sum £664,000 daily. The excess for the period was £361,000,000. The Chancellor reduced this sum by recoverable amounts of £206,750,000, leaving a dead overcharge of £154,250,000. He explained this excess as due to the increased activities of the army in Mesopotamia and Palestine.[1] The outlook for the coming year is not any more favorable in view of the call for more troops, the extension of the conscription age, the increased activity of the enemy on the western front, and the heavier claims of the Allies for more financial support.

The Progress of Expenditure

The progress of expenditure has already been shown by the steady growth in the total of votes of credit. This had reached for the fiscal year ending March 31, 1918, practically £2,800,000,000, and for the war up to April 1, 1918, £6,592,000,000, leaving the national debt about, including the prewar debt of £650,000,000, £5,800,000,000, March 31, 1918, or £5,150,000-000. It has been the purpose of every chancellor to meet the interest charges from taxation and this has been done in every instance. The criticism of Mr. McKenna that such was not the

[1] *Parliamentary Debates,* H. C., vol. 103, No. 15, p. 2137.

case in this year's finances was answered by Bonar Law in these words,

> that already in thirty-five weeks we know that the excess of revenue coming in over the budget estimate will more than cover interest and sinking fund on the increase of expenditure.[1]

The interest charge for this fiscal year will amount to at least £285,000,000. To this must be added a sinking fund charge and the ordinary cost of government in time of peace.

On May 8, 1917, *The Times* published a table showing the proportion of war revenue to expenses. This table covered the previous years of the war and gave the estimate for the present fiscal year. The table is reproduced below.

THE PROPORTION OF WAR REVENUE TO EXPENSES

	Expenses	Total Revenue	Percentage of Expense	Total Tax	Percentage of Expense
1913-14 ...	£ 197,000,000	£198,000,000	...	£163,000,000	...
1914-15 ...	563,000,000	226,000,000	40.1	189,000,000	33.6
1915-16 ...	1,559,000,000	336,000,000	21.5	290,000,000	18.6
1916-17 ...	2,198,000,000	573,000,000	26.07	514,000,000	23.4
1917-18 ...	2,290,000,000	638,000,000	27.08	569,000,000	24.8

The estimate for 1917-18 is not less than £500,000,000 too small. Two remarkable facts appear in this statistical presentation: one, the growth of war expenses from £563,000,000 of the first year of the war to nearly £3,000,000,000 in 1917-18; the second, the amount of revenue from taxation. At the time of the Crimean War the expense reached £69,277,694 of which £29,562,486 was paid from revenue. A more recent example is the South African War, which cost £217,166,000, and £58,456,-000 of that was paid out of revenue. Considering the enormous sum involved the showing of 27.08 per cent for revenue payments in this war is a notable accomplishment. On the other hand the enormity of the undertaking and the impending finan-

[1] *Parliamentary Debates*, H. C., December 2, 1917.

cial results place a greater responsibility upon the tax payer that has not brought all the results the advocates for more taxation think should have come to pass.

THE NATIONAL DEBT

If Mr. McKenna's prophecy is true that March 31, 1918, will see the national debt at £6,000,000,000 it becomes highly important to know what the nation has to meet the situation. Against this debt there will be by that date more or less recoverable amounts of £1,750,000,000 payable as advances and loans from the Allies and Dominions. In his speech of December 12, 1917, Bonar Law called attention to the national balance sheet which showed assets of nearly a billion pounds.[1] There were balances in the form of ships and stocks amounting to £250,000,000, excess profits on products that would amount to £200,000,000 and equipment in the form of buildings, machinery, etc., valued at a very large sum. These sums amount possibly to £750,000,000, which, added to the possibly recoverable amounts due from Allies and Dominions, make the assets £2,500,000,000 to offset the national debt of £5,800,000,000. The situation at the close of the present fiscal year would, therefore, appear to be something like this:

Total of national debt, March 31, 1918	£5,800,000,000
Advances to Allies and Dominions	1,500,000,000
Part of gift of Indian Government	66,000,000
Debt at beginning of war	645,000,000
Increase of debt due to war	3,600,000,000

The detailed statement of debt of the United Kingdom thus stood in February, 1918, at £5,678,800,000, distributed as shown in the following table:[2]

[1] *Parliamentary Debates*, H. C., December 12, 1917.
[2] *London Economist*, February 23, 1918.

Funded debt	£ 317,800,000
Terminable annuities	24,000,000
Unfunded debt	
3½ per cent war stock	62,700,000
4½ per cent war stock	20,000,000
4 and 5 per cent war stock	2,086,900,000
National war bonds	363,900,000
Treasury bills	1,054,800,000
Exchequer bonds	402,600,000
War savings certificates	120,300,000
War expenditure certificates	23,500,000
Other debt	861,900,000
American loans	51,400,000
Temporary advances	237,800,000
Other capital liabilities	51,200,000
	£5,678,800,000

The difference between the amount stated above and in this table is accounted for by the difference of about five weeks in the two statements.

CHAPTER V

War Loans and Financial Devices

In August, 1914, the Chancellor asked that the Treasury be permitted to borrow in such manner as it sees fit on the security of the Consolidated Fund. This proposal differed from all other war loan bills in that it did not state the actual amount nor the method by which the money was to be raised.[1] During the nearly four years of the war, the Treasury has taken advantage of this provision and tried many plans for securing funds. Beginning with a fairly well marked policy of formal loans, supplemented by short time borrowing, the Treasury has reached a policy of continuous borrowing without fixed subscription periods or especial emphasis upon any one type of security. The policy at the opening of the war may be epitomized as one which provided for the issue of a good sized loan, payable in two or three decades, at a good rate of interest, followed by smaller loans on long dated Exchequer bonds used to redeem Treasury bills when the amounts became too large. Coupled with these provisions was the sound purpose to hold in check the issue of paper currency.[2] The exigency of war has never been known to leave any plan intact, and the United Kingdom with all its experience in financial affairs finds itself a long way from the starting point of 1914.

The Great War Loans

All told there have been four great loans since the war started, though the last one did not have a fixed subscription period for the sale of bonds, as did the first three. The first loan was offered to the public in November, 1914, when £350,000,000

[1] Statement of Chancellor, *Parliamentary Debates*, H. C., August 25, 1914.
[2] *London Economist*, November 14, 1916, p. 863.

were subscribed, the second raised £616,000,000 in June, 1915, the third, £800,000,000 in January, 1917, and the last one was offered in October and November, 1917. The first three loans produced £1,800,000,000, the figures for the last loan show weekly sales varying from £9,000,000 to £40,000,000, though the average is in the neighborhood of £18,000,000. These offerings were not the only forms of borrowings undertaken; since the Treasury offered at the same time Exchequer bonds, Treasury bills, war expense certificates and savings stamp certificates. The results of these borrowing enterprises for the period August 1, 1914, to January, 1917, is well summarized in the appended table:

NET WAR TIME BORROWINGS AUGUST 1, 1914, TO JANUARY 20, 1917

3½ per cent loan	£ 331,798,000
4½ per cent loan	592,346,000
3 per cent Exchequer bonds (net)	30,571,000
5 per cent Exchequer bonds	334,519,000
6 per cent Exchequer bonds	160,831,000
War expenditure certificates	29,878,000
War savings certificates	44,800,000
First American loan	50,820,000
Net issues of Treasury bills	1,002,518,000
Ways and means advances, net	284,277,000
Net "other debt"	188,924,000
	£3,051,282,000
Deduct £160,427,623 repaid to Bank of England out of proceeds of 4½ per cent loan	160,428,000
	£2,890,854,000

Besides the items specified above we know that three loans were raised in America, amounting to £160,000,000, during the period covered, of which only one, for £60,000,000, is known to have been brought into the Exchequer. There was also a loan of 100,000,000 yen from Japan, and another believed to have been for $50,000,000 from Canada, but whether these advances are included in the item of "other debt" is known only to the initiated.[1]

Since this table was first printed the debt has been increased by the sale of bonds and certificates amounting to £2,778,000,000.

[1] *London Economist*, March 3, 1917, p. 424.

The borrowing transactions of the English Government may be grouped: (1) subscribed loans; (2) forced loans; and (3) negotiable loans. The first consists of the various offerings for subscriptions made to the public in the form of bonds, stamps, certificates and Treasury bills; the second of currency note issues and the American dollar security scheme by which foreign bonds were brought into the possession of the Treasury for collateral uses. If the war continues, the latter group may contain a larger share of financial proposals than it does now, since various suggestions are being made in the press, and even threatened by members of Parliament in their speeches on the present policy of the government, to establish a system of prescribed loans. The third class consists of the loans negotiated abroad.

The First War Loan

The first loan was offered in November, 1914, on a 3½ per cent basis at £95 per hundred with accumulated interest after December 7, 1914. The subscribers were required to deposit £2 on each £100 of their takings and to make payments of £3 December 7, £10 December 21, and a similar amount each two weeks until the payments were concluded April 26, 1915. These bonds are repayable in 1928 and may be paid at the option of the government, March 1, 1925. They are convertible into other bonds by the bearer and were issued in £100, £200, £500, and £1,000 denominations.[1] While Treasury bills were used to fill the gaps in the bond program at the time of the next loan, June, 1915, Chancellor McKenna, in explaining the situation, gave three reasons for the loan. One was, that the loan does not fall due at an early date, another was that its issue tends to assist the foreign exchange situation, and finally the loan policy reduces the expenses both in rate of interest and administration.[2] At the time the second loan was proposed £235,000,000 of Treasury bills had been sold, of which £16,500,000 had been used to pay off some of the Boer War debt.

[1] *London Gazette*, November 17, 1914.
[2] *The Times*, June 22, 1915.

The Second War Loan

The new loan was more elaborate in its provisions than the previous one. It carried with it extensive regulations for the conversion of older government securities and the sale of small denominations through the post office. No specific amount was set up as to the limit of the loan, and the reason for this was the purpose to convert the older government securities. The loan issued at par and carried an interest of 4½ per cent. It was payable in 1945 with an option of payment in 1925, and the conversion of consols was fixed at £75 of consols convertible into £50 of new loan with the understanding that the holders were to apply for £100 of the new loan. This made the exchange rate 66⅔ per cent. The annuities were exchangeable at £78 in 2½ per cent and £67 in 2¾ per cent to £50 of the new loan. Conversion of the first into the second loan was arranged on the basis of £95 of first loan and a cash payment of £5. The Bank of England was the fiscal agent, but the denominations sold through its agency were limited to £100. To meet the wishes of small investors, the post office was authorized to sell small denomination bonds of £5 and £25. Through the same agency scrip vouchers could be bought of £1, 10s. and 5s. until December 1 and used on the purchase of the £5 and £25 denominations which bore 5 per cent interest on calendar months or an interest of 4½ per cent for the actual time.[1]

Viewed from every point of financial test this loan was a vast success. The actual number of subscribers through the Bank of England was 550,000 and the amount subscribed by them reached £570,000,000. Nor does this sum include the conversions of old stock but represents new money. Up to July 10, 1915, the post office subscriptions were £15,000,000 by 47,000 persons. The total reached, during the subscription period, £600,000,000, the largest loan up to that time made by any people. It should also be stated that the joint stock banks took £200,000,000 of the

[1] *The Times*, June 22, 1915.

loan. The exchange transactions referred to above are set forth in the table below:[1]

Stock	Amount Previously Outstanding	Amount Converted	Balance Uncounted
Consols	£536,101,000	£204,000,000	£332,101,000
2½ per cent Annuities....	29,812,000	7,500,000	22,312,000
2¾ per cent Annuities....	3,813,000	1,000,000	2,813,000
3½ per cent War loan....	350,000,000	135,000,000	215,000,000
	£919,726,000	£347,500,000	£572,226,000

An announcement was issued on December 19, 1916, that a war loan bill would be passed before the prorogation of Parliament. The statement was likewise made two weeks later, that further sale of Exchequer bonds was to stop. In this provision the war savings certificates were included and all the signs pointed to a temporary suspension of the issue of Treasury bills as well. The country was " fed up " on short dated securities and the requirements of investors looked to a different form of security and relief from the short dated paper which in the case of the Treasury bills had reached £1,115,815,000 on December 31.[2]

The Terms of the Third Loan

The terms of the new loan were stated by Mr. Bonar Law in the House of Commons on January 11, 1917.[3] In order to test the demand for the tax bonds, the government determined to issue the loan in two forms. The first type of bond called for a 5 per cent interest payable in thirty years with an option of redemption at the end of twelve years. The price was fixed at £95, yielding almost exactly 5¼ per cent. The second was a tax compounded bond issued at par and returning 4 per cent redeemable at the end of twelve years and running for twenty-five years. The subscribers to the loan were to pay 5 per cent on application and the balance in even payments until May 30.

[1] *The Times History of the War;* vol. vii, p. 252.
[2] Report of War Cabinet for Year 1917, London, 1918, p. 211.
[3] *The Times,* January 12, 1917.

Owners of 4½ per cent, 5 per cent and 6 per cent loans were permitted to convert them into the new loan at par, while the holders of Treasury bills and war expense certificates could convert them at discount of 5 per cent for the first and 5½ per cent for the second. Unlike the provisions for the previous loans, this enterprise set up a new type of sinking fund which was to be used in purchasing stock whenever it fell below the issue price. Each month ⅛ of 1 per cent was to be set aside until a sum of £10,000,000 was accumulated to purchase stock. These conversion privileges had the immediate effect of raising the price of the 4½ per cent loans to 99. This loan did not carry the right of conversion as the previous ones had, evidencing the belief on the part of the government, at any rate, that the limit had been reached in the form of attractive terms. And the fact that it did not carry conversion rights for consols and the 3½ per cent war loan resulted in a decline of consols to 52¾ and of the 3½ per cent to 84¾.

An analysis of the results of the loan of January, 1917, shows the same amazing results. The applications through the Bank of England amounted to £819,586,000 and through the post office to £30,715,000. Conversions of Treasury bills added to £130,711,750 and war saving certificates were taken in the sum of £19,300,000, a grand total of £1,000,312,950. Counting all subscribers, including those who bought certificates of less than 15s. 6d. denominations, there were 8,000,000 persons participating. The bank and the post office reported more than 2,000,000 subscribers, of these the bank reported 1,089,000 and the post office 1,000,000.[1]

At the time of the issue of the loan the floating indebtedness was £1,562,000,000, of which £1,053,000,000 were Treasury bills, but the conversion of Treasury bills and Exchequer bonds for the new loan reduced the amount of the floating debt to £994,000,000.

[1] *The Times*, February 27, 1917.

Change of Loan Policy

In September, 1917, the government changed its policy of fixed subscription periods for the sale of bonds and began the experiment of financing the war by a continuous issue of national war bonds. The experiment opened well with an average of about eighteen millions a week for three weeks and dropped to £10,000,000 a week by the last of November. The minimum amount needed as stated by the Chancellor of the Exchequer in his speech on the occasion of the last vote of credit was £20,000,000 per week. Later statements of the success of his policy were presented by the Chancellor, March 13, 1918. At that time he said, during the campaign week ending March 7, that £127,870,240 of national war bonds were sold through the Bank of England, and since October 1, 1914, there had been £570,000,000 of war bonds sold. He spoke also of the sale of post office issues during the same weeks as having reached £2,900,000. Up to that time £138,870,240 of war saving certificates had been sold.[1]

The new issue was a combination of two distinct forms of borrowings: (1) short term securities and (2) on "tap sales" of three bonds of larger dated securities of seven year 5 per cent, ten year 5 per cent and two year 4 per cent income tax compounded bonds. The amount of these bonds for sale was unlimited, the denominations were made as low as £50 and the redemption periods placed at five, seven and ten years. Conversion rights were included in the privileges of holders not only in exchange for any future loans, but for the previous 5 per cent loan at £95 per cent. The bonds under this issue were accepted for death duties, excess profits or munitions Exchequer payments though this right was denied to foreign holders and persons not commonly resident in the Kingdom. These bonds were on sale continuously and a great campaign of publicity entered upon to bring them into public notice.

> In asking for weekly purchases of the bonds on this scale, the financial advisers of the government are asking for noth-

[1] *Parliamentary Debates*, 1918, vol. 104, p. 321.

ing either impossible or unreasonable, and it is for the moneyed classes to respond to the call of the state in more generous measure, even at the cost of sacrificing luxuries on the one hand or old habits and prejudices on the other. It should be done for patriotism, but it would be prudent, in our judgment, to do it only for personal interest. For if this issue of war bonds is withdrawn, it will only be after the government has been taught that the offer of good terms alone is not sufficiently potent a stimulus to voluntary lending, and those who kept their money back when it could have been placed patriotically on so favorable a basis may well find that the alternative is distinctly less attractive.[1]

Continuous Loan Policy

As shown in earlier chapters the financial policy of the government has changed a good deal in the four years of the war. What began as an experiment has hardened into a policy in that it has been two years since the government called for a loan of a fixed amount. The continuous loan from week to week had at least the advantage of drawing from the savings of the people the funds for war purposes, and avoided the necessity of negotiating extensive advances from the banks. A good deal of doubt existed as to the success of such a policy and if the government had not been able to avail itself of the advances from the United States Government, the success of the plan would have been much in question. The restrictions on new issues of capital have left practically no security for investment in other than government issues. Consequently, the statement recently made that the government has no present intention of issuing another fixed war loan is in line with the success of the plan so strongly adhered to by the present Chancellor, Bonar Law.

In order to encourage the sale of such bonds it has been repeatedly suggested that a premium feature should be made a part of the plan. The purpose is to give an additional choice in the purchase of government securities to those already in existence. Such bonds would be issued at a lower rate and at a discount with the possibility that in six months or a year, fortu-

[1] *The Times*, November 28, 1917.

nate holders might draw a larger bond as a prize or premium. The thought was to encourage investment and bring some groups to work harder in order to purchase premium bonds. The proposal has never been taken up largely on account of the discrimination against other types of securities and the inability to keep up the process of whetting the appetite for new premiums.

The Use of Treasury Bills

In addition to the currency issues the Treasury has relied on Treasury bills to meet its day to day expenditures expecting when these reached too large a sum to reduce the amount by the proceeds of Exchequer bonds and long term loans.[1] At times the Treasury bills have aggregated more than a billion pounds. On November 1, 1917, there were £985,720,000 of Treasury bills and £10,664,000 in Ways and Means advances outstanding.[2] There is, however, another point involved; fearing its inability to get the necessary funds by taxation the government has resorted extensively to this method of getting funds. The Treasury bill, a government obligation, promises big payment in a short period, usually three, six or nine months. The short three months bills are no longer issued and the time has been extended to six, nine and twelve months. These are offered in the market and were sold at first in certain amounts to the highest bidders. Later this method was abandoned and the Treasury fixed the price and sold to all comers over the counter. A good deal of discussion has arisen in England over the extensive use of the Treasury bill. Some authorities have argued for the use and others have protested vigorously against their extended use, due to the influence such vast sums of paper have upon prices and the artificial inflation of banking facilities.

The Exchequer Bond

The Exchequer bond is in fact a corollary in the principles of finance to the Treasury bills. In the nature of things short time

[1] *London Gazette*, August 17, 1917.
[2] *The Times*, November 1, 1917.

paper falls due and the government has the option of a big loan, short term bonds or the issue of another batch of Treasury bills. The three and five year Exchequer bonds have been used to fill the gap and through its agency reduce the amount of Treasury bills from time to time. The original prospectus issued in connection with the sale of the Exchequer bonds spoke only of five year bonds. These were discontinued January 1, 1916, and in their place the government established the three and five year bonds paying 5 per cent interest with the option of payment at the end of either period. In commenting on this innovation the *London Economist* suggested a two and a four year bond as being still better fitted to the needs of the Chancellor.[1] The large issue of Treasury bills has forced the government to pay what was termed an exceptionally high rate, 6 per cent, for Exchequer bonds. This was in November, 1916, but by the attractive offer the funds were forthcoming. The way in which the matter worked out, however, emphasizes the inherent difficulties of short term bonds as compared to the long term securities which in a measure ironed out the exigencies of the immediate future. Chancellor Bonar Law has been much in favor of continuous borrowing with its Treasury bills, Exchequer bonds and long term securities on sale at all times. The first produces the immediate credit, the second relieves the pressure more or less temporarily, and the third disposes of it for a decade or more. In December, 1917, a public announcement was made that all issues of Exchequer bonds would be stopped. This left Treasury bills and war saving certificates as the only issues for public borrowing, the purpose being to concentrate public attention upon the new war loan which was to be placed upon continuous sale.[2]

Issue of Currency Notes

Since the opening of the war an enormous mass of new currency has come into existence.[3] Formerly gold circulated freely

[1] *London Economist*, vol. 82, p. 1021.
[2] *The Times*, January 1, 1917.
[3] *London Economist*, March 10, 1917.

in Great Britain, but it has been forced out of circulation into the reserves of banks, and paper money has been issued in its place. Just how far this process has gone is shown in this table for the two years ending June, 1916.[1]

	Gold	Per Cent Increase	Paper	Per Cent Increase
Great Britain	£42,719,000	106.6	£160,036,000	544.0
France	40,730,000	25.1	425,107,000	175.6
Italy	12,897,000	26.3	90,112,000	144.6
Russia	184,678,000	104.0	695,834,000	426.0
Japan	11,606,000	53.0	16,298,000	49.7
Germany	60,716,000	93.0	432,404,000	359.3
Austria-Hungary			183,119,000	189.0
	£353,346,000	57.6	£2,002,910,000	268.0

Up to a little more than a year later, August, 17, 1917, than the table above shows, there had been issued £475,258,627 of one pound notes, £150,186,838 of 10s. notes and £42,408,000 of currency note certificates. Of this vast sum £503,749,128 were cancelled leaving the situation in this form:

Outstanding £1 notes	£125,663,567
Outstanding 10s. notes	32,526,938
Outstanding currency note certificates	14,950,000
	£173,140,505

The Treasury held against this sum gold coin and bullion £28,500,000, government securities £146,219,665.15 and balances in the bank £5,180,929 11s. 15d. The difference between these assets and the outstanding obligation is termed an investment reserve amounting to £7,169,090 7s. 5d. The important phases of this group of figures are the great mass of paper money and the amount of government securities held as assets by the Treasury against its own paper issues.

Loans Made Abroad

Great as has been the success of the efforts of Great Britain to raise loans at home she has alone and in conjunction with France placed several loans in America. The terms of the loan made in 1915 provided for the issue of bonds $500,000,000 in

[1] *London Economist,* March 10, 1917.

amount at a price of 96 to the underwriters and 98 to the public. The rate was 5 per cent, the period five years, and the bonds were convertible into 4½ per cent bonds payable in fifteen years and before twenty-five. The price at which the bonds were sold made a return of 5½ per cent. The loan, however, was negotiated for the purpose of maintaining exchange by the establishment of a credit in New York against future purchases. The loan was easily taken, the majority of the underwriters preferring to hold their subscriptions for their own account. Earlier in the year the English Government had received tenders for $250,000,000 of five year Exchequer bonds bearing 3 per cent and selling at a price which brought 3⅞ per cent to buyers. The second secured gold loan by the United Kingdom was brought out sooner than was expected. This loan was negotiated in October of 1916 for $300,000,000 at 5½ per cent. One-half of the loan matured in three years and was offered to the public at 99¼, the second half was for five years and sold at 98½. This loan was secured by collaterals consisting of American and Canadian railway stocks and government securities of British Dominions, South American Governments, Cuba, Japan, Egypt, and India. The loan was repayable in United States gold coin or in British sterling at $4.86½ per pound. The attitude of American bankers toward these loans was to encourage the offerings in the New York market as fast as they could be absorbed, hoping in this way to facilitate foreign purchases and to reduce current gold importations. The entrance of America into the war changed the whole course of British financing so far as the placing of loans in America was concerned. The government has now become the banker and advances are made in money in exchange for the obligations of Great Britain at the same rate of interest as that on bonds or certificates of indebtedness which the Secretary of the Treasury sells to raise the needed funds.[1] Up to March 18, 1918, Great Britain has received $2,390,000,000.[2]

[1] *The Annalist*, October 22, 1917.
[2] *Federal Reserve Bulletin*, April, 1918, p. 279.

CHAPTER VI

Foreign Exchange and the Dollar Security Scheme

On the face of it there seems to be no great importance in the problem of exchange as a war question, yet it came to be a war loan question of vast importance to Great Britain in meeting war expenditures abroad. In previous chapters, II and III, something of the situation that faced English foreign trade at the opening of the war was brought to the attention of the reader. Great Britain enjoyed an immense world trade, thus bringing to her people the returns from freight, insurance and banking profits arising out of the business of banker and carrier to the world. When the war came bills of exchange suddenly ceased to be current and the machinery of international exchange broke down. Rates of exchange for sterling bills on London rose to unheard of prices. The very success of the English financial system in laying the world subject to it stood in the way of its continuance when war stopped the movement of goods. Centuries of world trade had given the English people enormous investment abroad with annual interest and dividend payments of hundreds of millions. It has been stated that the United Kingdom had not less than £4,000,000,000 invested in foreign countries, one-half of which was in North and South America. In the United States the holdings were estimated at $4,500,000,000 and in Canada at $2,500,000,000. The joint stock banks and acceptance houses ceased on the declaration of war to purchase foreign bills and began calling in their loans. This action embarrassed the whole process of payment, not only of dividends and of interest, but of debts due for insurance, freight and goods as well. Such a result was the natural outcome of a war involving a considerable number of great Powers, but the difficulties of exchange even after the adjustments brought about

by the emergency measures had been made have continued and will undoubtedly continue during the whole course of the war and for some time after.

Periods in the Foreign Exchange Problem

The problem of foreign exchange may be divided, therefore, into two distinct periods: the first, the time of panic and disorganization at the outbreak of the war, and the second, the lengthening period of the war during which there is a gradual accumulating effect of the war conditions and war expenditures upon the financial relations of each of the combatants and neutrals.

The first period has been given consideration at some length in earlier chapters, the second, if pursued in all its phases would carry the investigation into details which can not be followed in a book of limited scope. As is indicated by the title of this chapter it is to one phase of the situation more than the other, that special emphasis is to be paid, that of the dollar security scheme. Before entering upon it, however, it seems desirable to glance for a brief period at the general exchange situation.

The outbreak of the war created a worldwide demand for exchange on London. All the banking centers in the world were looking for sterling exchange, seeking to convert their credits into sterling. About the only place in the world where moratoria had not been declared was in the United States and in consequence these countries were trying to use their credits in America to pay London. New York could not use her offsets against these credits on account of the moratoria. In ordinary times the international bankers arranged these credits and debits of individuals and corporations to offset one another; but under the conditions this was impossible so that New York, as the center of American finance, was called to pay one side of a running account for the whole world. The best that the debtors could do was to pay into a bank and notify creditors that the account was at their disposal. A situation of this kind encour-

aged gold exportation. The outcome was the creation of a New York bankers' committee and the establishment of a $100,000,000 gold fund to be used in remedying the exchange situation in New York. In December, 1914, exchange relations between London and New York were normal, but in February, London exchange in New York went to $4.79, the lowest point ever known up to that time. London had come to our New York, but the cost of shipping gold across the Atlantic was prohibitive under war conditions. The whole situation was the reverse of the conditions of the last part of the previous year.

The Sterling Exchange Situation

By January, 1915, the $400,000,000 estimated annual indebtedness due in England from Americans had been extended or reinvested and a considerable body of securities purchased. This in fact was the only way likely to be available in paying the trade balance against Great Britain since she could not pay in gold or settle in goods. It was from this viewpoint that the Chancellor of the Exchequer stated Great Britain could pay the expenses of the war for five years from the proceeds of her foreign investments. In March, 1915, sterling exchange went to a lower figure. The Bank of England used its store of gold to pay exchange at the rate of $4.813, but it became increasingly clearer as the year advanced that a large balance in favor of America was accumulating. By July, 1915, the American current indebtedness in London had been wiped out, speculative holdings in American securities liquidated and many thousands of securities sold in New York. Despite these conditions gold continued to come and the sterling rate to fall to $4.76¼. Meantime the Ottawa gold account had been exhausted, so that the way out of the difficulty pointed to the borrowing of American securities in Great Britain and pledging them in America as the basis of an issue of notes.[1]

The exchange situation grew steadily worse by September,

[1] *National City Bank Bulletin*, July, 1915.

1915, when sterling exchange fell to \$4.55½ despite the fact that \$50,000,000 in gold had been transferred to America and as much more in the form of securities. Any further decline was disastrous to the English and embarrassing to American bankers. The United States could not well use more gold since the amount received in the previous nine months amounted to \$200,000,000 and the annual production was fully \$100,000,000 more. Such a situation could not well continue without some attempts at betterment. With this in view the Anglo-French Commission visited America in October and began at once the negotiations for a large loan. The plan to require the deposit of American securities as collateral was seemingly not feasible in view of the need of haste since sterling exchange had gone down to \$4.49 and the fact that the English Government did not own any American securities. The conclusion was the placing of the Anglo-French loan of \$500,000,000 and the depositing of the proceeds in American banks as a means of purchasing supplies for the English and French Governments.

The Dollar Security Scheme

The first English allusion to the use of American securities as a means of controlling sterling exchange on New York was made in *The Times* on November 17, 1915. Prior to the coming of the Anglo-French Commission, bankers of New York had urged the pledging of securities for loan collateral. The gold situation was artificial, the gold was difficult to use as a basis for the balance of the exchange between London and New York so that some other means had to be found to affect the situation. The government did not own securities and to acquire them was at any rate the first problem to work out.

The plan was entered upon the latter part of 1915 and contemplated the purchase or the borrowing of American securities. Beginning with an option for the holder the plan of realizing American securities proceeded in its final form to a compulsion tax upon all security holders who did not surrender their holdings

to the government for purchase or loan. In explaining the plan the Chancellor said: [1]

> The government wanted to get these securities, as far as possible, into one hand so that they might be controlled and used for the purpose of paying our debts in the United States. They believed that these securities would afford us a very great resource which would be fully sufficient to meet our liabilities, and therefore to maintain a good level of exchange with the United States for a period which he trusted would last as long as the war would last. The government recognized to the full that it was as much to our interest as it was the interest of the United States that nothing should be done which would embarrass their market or injure their financial business, and therefore the government would certainly exercise every care that nothing was done to embarrass the financial interest in the United States.

In the debate that followed it was declared that a national register should be established and all owners of American securities be required to register them. In fact a financial Lord Derby was wanted if the plan was to come to a successful conclusion. How prophetic this statement was is clearly evinced in the government's acceptance of compulsion as a necessary attitude in the successful use of securities for the purposes of the government.

The Details of the Plan

As originally presented the plan had three parts. The first of these may be called the purchase scheme which provided that the government might buy such securities outright at the New York quotation and pay for them in five per cent Exchequer bonds. The second part permitted the owner to loan his securities to the government for use as collateral to Treasury loans. If he did this the owner continued to receive interest or dividends and a bonus of one-half of one per cent on the face value of his loaned holdings. The third part gave the government the option of selling the borrowed securities, if necessary to do so, in which

[1] *The Times,* December 14, 1915.

case it agreed to add 2½ per cent to the average of the high and low New York quotations on the day of the sale. In the course of a few months the plan was materially elaborated and two types of schemes set up, known as A and B.

While the government evidently preferred to buy securities outright as shown in the remark of Chancellor McKenna "that the government would be ready to purchase £100,000,000 of securities in a fortnight" the A and B schemes provided for the loaning of securities to the government.[1] Scheme A permitted the deposit of securities for two years with the option of transferring them to the Treasury for a longer period under the B part of the plan, and at the same time permitting the sale of the securities under certain conditions. The owner was to have in addition to his dividends or interest ½ per cent on the face value of his security. In case the Treasury found it necessary to sell he was to have 2½ per cent on value. To the lender was preserved the right to sell providing the securities were released in New York against payments to the Treasury agents there. In case the Treasury sold the lender could buy back inside of 14 days by the payment of the market price in dollars. On December 16, 1916, the A part of the scheme was withdrawn and the transactions carried on under the B plan.

This plan provided for borrowing securities for five years though the Treasury was permitted to return them on three months' notice after two years. Under any circumstances the lender was to receive ½ per cent per annum on the face value whether sold or not. If they were sold the lender could require the government to replace his securities of the same character and value. If they were sold he could have the deposit returned in cash with a bonus of 5 per cent together with the accrued interest. Negotiable certificates were issued for all securities lent to the Treasury. Despite the attractiveness of the plan it did not bring in as many securities as were hoped for. In consequence a 2s. penal tax was placed on the income of listed securities not brought to the government. The criticism of

[1] *The Times,* December 14, 1915.

scheme A was made on the ground that it did not provide for a guaranteed price in case of sale, while scheme B was objected to because of the absence of the power of sale. Under the modified form in which scheme B afterwards appeared, scheme A having been withdrawn, these criticisms were adopted and the new scheme embraced both advantages thus giving to the Treasury the necessary right of purchase. How far the scheme went in bringing securities to the Treasury is well indicated by the statement in *The Times*[1] to the effect that of the $4,500,000,000 of American securities, not less than $2,000,000,000 had been deposited by their English holders.

The fourth list of securities carrying the number to 900 was published May 6, 1917. This was the last list as it practically exhausted the number of securities subject to the 2s. tax. Any extension of it would have to include the securities which the holder had not had the opportunity of lending to the government. A few days later after the issue of the statement above, the Treasury declared its purpose to discontinue the borrowing of securities under scheme B except in list subject to the penal tax, though about 60 per cent of these would be subject to the scheme.[2] The declaration of war by America relieved the pressure upon the dollar security scheme and immediately affected the price of sterling exchange, carrying it to $4.77·¼.[3] The whole exchange situation was thus altered and the responsibility of sending gold to New York materially reduced. Loans to Great Britain by the United States created the credits needed in New York, and the Treasury was able to announce in September that certain securities are withdrawn from the list as the Treasury has sufficient for its purpose.

[1] *The Times*, January 19, 1917.
[2] *Ibid.*, May 12, 1917.
[3] *Ibid.*, April 11, 1917.

CHAPTER VII

The English Taxation Policy

The foundation of English financial policy in the conduct of war has been and is, despite the criticisms implying the contrary, the system of taxation. The current expenses of government must be maintained and the interest and sinking fund of the public debt be paid by taxation. In the final analysis a war is financed from savings which may be brought into government hands by loans or taxation. The economic effects of the two methods differ, but no nation can finance its wars by taxes alone or by savings alone; hence the policy of taxation, supplemented by loans, becomes the fixed national policy. In the opinion of many English publicists the United Kingdom has not used the power of taxation sufficiently to prevent the drift into the third method of financing wars, that of the use of compulsory loans, the issue of paper money. There must always come an end to borrowing, forcing the government to resort to increased taxation to pay the burdens of interest and sinking fund. There is always a tendency to let finance drift along the line of least resistance. Now and then ministers get away from this tendency under the fire of criticism, but the conservatism of a people causes them to look askance at new projects of taxation and the national policy thus drifts again into old channels.

Taxes of the First Budget

The Lloyd George budget of November, 1914, increased the rates of the previous peace list and to these his April, 1915, budget added no new taxes; the McKenna budget increased the rates of the George proposals while the Bonar Law budgets faced by an addition of £1,650,000,000 in the expenditure during a

single year did not add new taxes or venture into fields entered by his predecessors.[1] In fact, an examination of the English taxation of the war shows, taking the burden of the war into consideration, a surprising adherence to a limited number of taxes. There certainly was plenty of room for a longer array of indirect taxes than have been imposed. Perhaps the view-point is brought out in the statement of the London *Times* as early as February, 1916, that

> the singular spectacle was presented of the tax payers, headed by the city urging the government to tax them well; and when the new war taxes were proposed in the supplementary budget in the autumn, surprise was expressed at their moderation as a whole.[2]

However, as the war has gone on it is being clearly demonstrated that both increases and new forms of taxes will have to be resorted to in order to fulfil the English boast that normal expenses and the cost of interest and sinking fund shall always be met by taxation and not by borrowings.

The new taxes imposed by the supplementary budget of November, 1914, established a fiscal policy that has been pretty well adhered to during the war. The new taxes proposed were estimated to produce £15,500,000 in the remainder of 1914-15 (April 1, 1915) and £65,000,000 more in the fiscal year 1915-16. Of the amount to be derived in this way one-third was to come from customs and excise and the remainder from additional income taxes. The burdens for the customs and excise were placed upon tea and beer and the grading of incomes into three classes: earned, partly earned and partly unearned, with exemption at the bottom of earned incomes. These provided the basis for the revenue from the income tax.

The maker of the first war budget was confronted by a number of unknown factors and checked in his levying of new forms of taxation by what he regarded as well established prin-

[1] *London Economist,* June 9, 1917.
[2] *The Times,* February 7, 1916.

ciples. First was the length of the war, variously estimated at six months to three years, and wholly unknown to the Chancellor of the Exchequer. Second was the daily rate of expenditure that has now turned out to be enormously larger than anybody even dreamed of at the opening of the war. In this last factor were problems of man power, munitions, supplies, food and transportation, many of which had to be worked out on an entirely new basis. The principles of finance were also limiting elements in the problem. One of the first of these is the limit to any scheme of taxation that can be imposed at one and the same time, and the further fact that the state can not create wealth, it can only organize it. The necessity of maintaining industry and employment made the adage about the goose that laid the golden egg applicable to the problem at hand and held back the Chancellor from new taxes and excessive increases of old ones. Beginning with moderate increases over the peace budget of 1914-15, which included the most extensive system of taxation ever devised in the Kingdom, the successive budgets have materially increased the rates of taxation for war purposes. Speaking somewhat broadly the tax plans may be grouped into the two large classes of excise and customs and the income tax.

Beer and Tea Taxes

There is always an inherent difficulty in the imposition of indirect taxes which can never be escaped. And this difficulty, summarized in their inequality, makes them not altogether desirable taxes. Beer and tea, however, have been attractive objects of taxation and frequently resorted to by English financiers for revenue. At the opening of the war beer was paying a tax of 7s. 9d. per barrel and tea 5d. per pound. The proposals of the first budget raised the beer tax to 25s. and the tea tax to 8d. If beer had been charged on the basis of spirits, the tax would have been £2 7s. 10d. per barrel as against 7s. 9d. as beer. The basis of the standard was 55 per cent grade allowing 9° of spirit. The Chancellor, however, made a number of concessions

such as reducing the tax to ½d. to a half-pint of beer and allowing brewers a month's credit in the payment of the tax. Whiskies and wines were left where they were. The state of the trade was frequently referred to in the discussion and evidently the tax was to be tempered for the brewer and the retailer. As soon as the tax was determined the brewers raised the price of beer approximately £1 to the barrel of thirty-six gallons. Of the £1 taxes the brewer was to pay 17s. 3d. and the retailer the balance, but as the increased price of ½d. per half-pint realized 24s. per thirty-six gallons, the brewer had 6s. 9d. per barrel to cover the estimated losses of the trade due to decline in consumption.[1] The effects of the tax were gloomily prophesied by the brewing interests, but despite the tax and the far reaching restrictions placed on the licensed trade the brewing companies have been reaping a harvest that was not thought possible two or three years ago.[2]

Greater variation had prevailed in the levying of the tea tax. The uniform rate of 2s. 1d. per pound which had prevailed since 1836 was reduced to 1s. 9d. in 1853, and 1s. 6d. in 1854, raised to 1s. 9d. in the Crimean War and reduced to 1s. 5d. in 1857 and finally to 6d. in 1865 where it remained until 1889 when the tax was reduced to 4d. The Boer War brought it up again to 6d. and since that time it had been lowered to 5d. where it stood at the opening of the war. The war budget added 3d. in 1914 and 4d. more in the budget of 1915. Other custom and excise duties were laid on sugar, tobacco, coffee, cocoa, motor spirits and patent medicines by the budget of 1915. The duty on sugar was increased from 1s. 10d. per hundredweight to 9s. 4d. per hundredweight with a resultant raise of price to the customer of only 5s. per hundredweight owing to the reduction of price to refiners by the royal commission on sugar supplies whose early operations had given them considerable supplies of sugar. The tax on tea, tobacco, cocoa, coffee and chicory was increased and an addition of 50 per cent expected over previous returns from such

[1] *The Times,* November 20, 1914.
[2] *New York Times Annalist,* August 27, 1917.

taxes. The duty on motor spirits was 3d. per gallon, the patent medicine tax doubled and the duty on motor cars, clocks, films, etc., made 33⅓ per cent ad valorem. The principal emphasis of this budget so far as taxation was concerned was upon the income and excess profits tax, though the ad valorem tax started the smoldering fires of controversy over free trade and protection. The government, however, protested against any purpose to raise the question since it had been proposed not on fiscal, but economic, grounds.[1] The new tax proposals were regarded as inadequate in many quarters, for, says *The Economist,* "What a prospect that we should have trebled our debts and doubled our taxes."[2]

The indirect taxes of the next budget were more far reaching and materially added to the rather meager list of the previous budget. The Chancellor did not ask for an increase in the tax on tea and tobacco over that in the Finance Bill of September, 1915, nor were fresh attempts made to prevent consumption of luxuries by taxation. The license duty on motor cars which proposed a material raise of one hundred per cent in the duty on imported cars of less than sixteen horse power and trebled the rate on higher powered cars was not accepted by Parliament, but a tax placed on gasoline in lieu of it. The tax on cocoa and coffee was raised to 6d., afterwards reduced to 4½d., and the sugar tax was increased by ½d.; matches and mineral waters were added to the list. Two new taxes appear in the list. These are the amusement and railroad ticket tax. A total revenue of £5,000,000 was expected from the amusement tax which varied from ½d. on twopenny tickets to one shilling on the 12s. 6d. tickets. Railway tickets were slated for a tax of one penny for journeys costing 9d. to one shilling and an additional penny for every shilling or fraction or part of a shilling, a proposal which the House failed to accept. The budget of the following year, May, 1917, continued the taxes in force without much modification under the general plea of cost of collection and the depletion

[1] *The Times,* September 30, 1915.
[2] *London Economist,* September 25, 1915.

of the tax collecting staff. The exceptions to the statement are the amusement tax which was raised and the increase on tobacco.

The Income Tax

The income tax has long been considered the cornerstone of English finance. During Gladstone's time it was referred to as the sheet anchor of wartime finance to be supplemented by severe duties on consumed luxuries such as beer, spirits, tobacco, and tea.[1]

The tax was introduced by Pitt in 1798 as a war tax and the supposition was for fifty years that it was a war tax. The year after it was introduced the tax was repealed and a straight 10 per cent tax imposed upon incomes of more than £60 with possible abatements up to £200. The practice of charging at the source came in the year 1803 and the whole tax was repealed in 1816 and was not revived for general revenue purposes until 1842. This act is the basis of the present law. In 1853 the act was repealed and reenacted in more detail and contained the present schedules, and general provisions regulating the tax. Since then numerous amending acts have been passed altering the details relating to assessment and abatement. The Finance Act of 1907 granted relief to those assessed on earned incomes, the Finance Act of 1910 introduced the supertax idea and the Finance Act of 1914 permitted separate assessment of the income of husband and wife. A new bill, proposed by the Lord Chancellor, has been introduced in both houses of Parliament consolidating the present statutes and providing for an adequate statement of existing law, something which has been found necessary under war conditions.[2] It deals with fifty statutes and contains 236 clauses arranged in nine parts, as follows: I. Change of Income Tax, II. Supertax, III. Exemptions, IV. Administration, V. Assessment, VI. Appeals, VII. Collections, VIII. Ireland, IX. Miscellaneous.[3]

In this war the trend of government toward the taxation of

[1] Morley: *Life of Gladstone*, vol. i, pp. 517-518.
[2] *Solicitors Journal and Weekly Reports*, March 16, 1918.
[3] Income Tax Bill, House of Lords, August 3, 1917 (8 George V).

income has grown more pronounced as the war has gone on. In the last peace budget, the income tax varied from 9d. to 1s. 8d. in the pound.

> In the budget of May 4, 1914, which received its final modifications on June 23, little more than a month before it was knocked to pieces by the outbreak of the war, the nominal rates of income tax for third class incomes (wholly earned), 9d. in the pound up to £1,000 a year, 10½d. between £1,000 and £1,500, 1s. between £1,500 and £2,000, 1s. 2d. between £2,000 and £2,500, 1s. 4d. between £2,500 and £3,000. At £3,000 a year supertax comes into play, and from this level upwards a second ascending scale was applied. If the income were exactly £3,000 the owner had to pay an extra 5d. in the pound on £500 of it. If it were between £3,000 and £4,000, he had to pay 7d. extra on all over £3,000. If it were between £4,000 and £5,000, he had to pay an extra 9d. on all over £4,000. If it were between £5,000 and £6,000, he had to pay 1s. 1d. extra on all over £5,000. If it were between £6,000 and £7,000, all over £6,000 had to pay 1s. 3d. extra. From £7,000 a year upward the supertax was to be 1s. 4d. in the pound. This exactly doubled the ordinary tax on unearned income which had been originally fixed in May at 1s. 4d. in the pound, but was reduced in June to 1s. 3d.[1]

It was this peace budget that was taken as the basis of the first war budget in November, 1914. The rates of income tax were graded up and from these were expected £38,750,000 in increases from the income tax and £6,000,000 in supertax additions. On all earned incomes the rate was made in the November budget 1s. 8d., on partly earned incomes 2s. 4d., and 2s. 4d. on unearned incomes of £200. As this rate did not apply on the early period of the fiscal year it made the rate 1s. 6d. on earned incomes of £200 from December to April, 1915. The rate on £3,000 income when the supertax began amounted to 15s. under the peace budget and 20s. on the new war budget. The supertax was 5s. 13d. additional so that the recipient of a £3,000 in-

[1] Lawson: *British War Finance,* p. 296.

come paid £264 income and supertax. For incomes of £100,000 a year the combined rate amounted to 40s. 4d. or a payment under the gradations of £16,830 11s. 1d. When the next budget was arranged in September, 1915, the existing income tax rates were raised 40 per cent. However, as this rate did not go into effect until the passage of the finance bill the actual result so far as tax payers were concerned was but half of this or 20 per cent. Under the old tax (December, 1914) unearned income paid the minimum tax of 3s. 6d. in the pound and 3s. 6d. on the net tax which made 3s. for the year. On earned income the minimum old tax was 1s. 6d. in the pound and 2s. 1d. in the pound for the new tax. The former exemption of £160 was reduced to £130 which practically made a wage tax for those who had incomes of more than £2 10s. a week. The highest abatement that could be claimed was fixed at £120 in any case. Incomes of over £8,000 formerly chargeable at 2s. 8d. in the pound for supertax were required to pay 2s. 10d. and for the surplus over £10,000 a supertax of 3s. 6d. The general scheme of the tax is indicated in the table below as shown in the tax on wholly earned incomes.

TAX ON WHOLLY EARNED INCOME [1]

Income	Old Rate			Rate for Year 1914-15			Full New Rate		
£	£	s	d	£	s	d	£	s	d
131	0	0	0	0	19	8½	1	2	11
160	0	0	0	3	11	8	4	3	4
161	0	1	6	3	13	5½	4	5	5
200	3	0	0	7	3	4	8	6	8
300	10	10	0	16	2	6	18	15	0
401	18	6	6	26	19	3½	31	7	1
501	26	5	0	35	18	5½	41	15	5
601	39	16	6	47	11	4½	55	6	3
701	52	11	6	62	15	11½	73	0	5
1,000	75	0	0	89	11	8	104	3	4

When the law reached its full effect as a tax levy the owner of a £1,000 income would be called upon to pay £104 3s. 4d. as his contribution to war expenditures.

The Chancellor, however, when he presented his budget in April, 1916, again proposed modifications in the income tax

[1] *The Times*, September 22, 1915.

which provided for a lower rate for lower amounts of incomes, but increased the maximum rate of the tax to 5s. on incomes exceeding £2,500. The distinction between unearned and earned income was continued and the rate increased, so that on incomes not exceeding £300 it was 3s., but for incomes of such a character over £2,000 it rose from an additional 6d. to 5s. Resorting again to a table the rates appear in the following form:

Income	Earned Income	Unearned Income
£	s d	s d
Under 300	2 3	3 0
300-500	2 3	3 6
500-1,000	2 6	4 0
1,000-1,500	3 0	4 6
1,500-2,000	3 8	4 6
2,000-2,500	4 4	5 0
2,500 and above	5 0	5 0

The surtax remained as it was, but began at the five shilling point, which makes it more severe than the £3,000 surtax point.

When the next budget came up, in May, 1917, the Chancellor did not present any changes in the income tax, insisting that at this stage of the war a stationary income tax was a sign of national strength.[1] In consequence the rates and general provision remained as presented in the previous budget.

As was to be expected, various schemes were developed to evade the tax. Life insurance, originally the poor man's method of protecting his family from destitution, became the rich man's device to save his pocket book from taxation. The life insurance companies began to do an increasing business in short term endowment policies. The government met this situation by making the exemption depend upon the size of the income and not the terms of the policy. On the other hand some tax payers found themselves called upon to pay two income taxes. This was specially true of Australians living in England. It was evident that England must maintain her fiscal independence, since if she chose to give up her claim to such income because Australia levied a tax she might lose it all. This situation was met by

[1] *The Times,* May 3, 1917.

the wise compromise of allowing a rebate on what had been paid in Australia, but only to the extent of 1s. 6d. in the pound.[1] The burden of the war income tax was reflected in the demand for urban property. Houses under £50 rent sold well, but the war tax, with a high bank rate and the government borrowings depressed the demand for gilt edge property especially in the instance of ground rents, but agricultural lands maintained their previous firmness tending to bring about the breaking up of estates.[2]

The Excess Profits Tax

An additional feature of the income tax remains to be discussed in the form of the excess profits tax.

In clause 35 of the budget of November, 1915, a war profits tax of 50 per cent is set up and made applicable to incomes for the period from August 4, 1914, to July 1, 1915, on any excess of £200 over the defined prewar standard of profits. The determination of this standard was a matter of serious import. The Treasury had no desire to injure business, yet at the same time it was insistent upon revenue from the returns coming to business concerns from the war conditions. It was pointed out that profits were not to be calculated by income tax rules, but deductions were allowed for interest, rent, royalties on other payments excluded under income tax accounts, because already collected at the source. The basis for profits was determined by the average of any two of the three prewar years. If these years were shown to be ones of depression the concern was permitted to take any four of the last six years. Even this provision was guarded by confining a depression to returns of at least 25 per cent less than those of the last three years. The law did not make any distinctions between profits earned from higher prices and those gained by increased output, but it did endeavor to define rather carefully the meaning of capital upon which dividend rates and earnings were calculated.

[1] *London Economist*, December 30, 1916.
[2] *Ibid.*, January 6, 1917.

Insofar as the capital was not money, it could consist of the price at which the assets were purchased subject to deductions for wear and tear and nonpayment of money. In the matter of good will the value of the asset could be counted at the time acquired, but no allowance could be made if the value of good will was the basis of share capital. The value of other assets subject to wear and tear was included and capital that arose from the trade or business, subject to deductions of debts which have been allowed for income tax purposes, was also included. The datum line for returns was fixed at the previous average and in no case was placed at less than 6 per cent. There was general acceptance of the burden though the tax developed a good many defects both in administration and practice. In the following year the 50 per cent tax was raised to 60 per cent.[1] A new type of classification was made under the head of controlled firms which permitted them to retain 20 per cent above the previous standard, the remaining portion going to the state. Once more the excess profits tax was raised, this time to 80 per cent.[2] By this act the munitions levy after January 1, 1917, was abolished and merged with the profits tax and all business concerns subject to it even though not touched by the war. In defending this change in the application of the tax the Chancellor stated that he knew the difficulties falling on concerns by reason of the widening scope of the tax, but that he knew of no other form of taxation which on the whole would be fairer and less detrimental to national interests. The value of this tax is well shown by the returns for the year closing April 1, 1918, which amounted to £220,-214,000 or 36 per cent of the tax revenue for the year. The income tax brought £239,509,000 in to the Treasury for the same period or 39 per cent. The two taxes produce 75 per cent of the total tax revenue. In general, the estimates of tax returns have been below the actual receipts. The following table indicates the results.[3]

[1] *The Times*, April 2, 1916.
[2] *Parliamentary Debates*, H. C., May 2, 1917.
[3] *The Times*, April 1, 1918.

	Excess of Revenue Over Budget Estimates	Excess Tax Revenue
1914-15	£ 17,488,080	£ 15,529,000
1915-16	31,766,824	13,464,000
1916-17	71,152,582	56,980,000
1917-18	68,634,565	43,340,000
	£189,042,051	£129,313,000

CHAPTER VIII

Inflation and Other War Costs

As this monograph is limited to a discussion of financial matters associated with the war, the many burdens, griefs and suffering that came from its prosecution can not be considered and such burdens as may be brought to the attention of the reader are limited to the money side even of the numerous ones that might be classed as economic.

TYPE OF INFLATION

Almost from the beginning of the conflict publicists have called attention to the process of inflation going on and the evils associated with it. In America inflation has been thought of as a matter almost wholly connected with the issue of paper money in time of crisis. Our experience with the greenbacks in the Civil War, to say nothing of the rich story of monetary experience in the Revolution and the experiments with state banks and silver certificates, have limited the idea of inflation prettty much to the issue of fiat and semi-fiat money. The discussion in Great Britain, however, centers around another phase of war finance. While it is true that the Treasury has steadily increased the output of ten shilling and one pound notes the public attention is more specifically fastened upon the changing ratio of taxation and the borrowing policy of the nation. The policy adopted has a far reaching effect upon prices and the ultimate conduct of the war. How this comes about is not a simple matter.

The injection of large sums of paper money into the financial system of a country by a government intent upon securing the necessary means of conducting a war has an immediate effect that closely follows the laws of supply and demand. On the

other hand, the call for voluntary loans from the savings of the country means the shifting of purchasing power from lender to government and the stimulation of demand for munitions and commodities required for war purposes. This demand raises the prices of such articles and also reduces the demand for other commodities outside the list of war commodities. Such a situation is based on the supposition that the loan to the government is made from national savings. When, however, these loans are larger than the savings of the country can swing, and the future savings of the country are drawn upon through the use of banking credit a series of hypothecating movements begin that may have far reaching effects upon credits, prices and the distribution of capital.

The Process of Inflation

How this interesting process makes itself felt was described by Sir Edward Holden, an eminent banking authority, in a speech in Parliament.[1] He called attention to the fact that between June, 1914, and the end of 1916 the Bank of England and the principal joint stock banks had created on balance an additional banking credit of about £193,000,000. The government had been responsible for the creation of credit by borrowing over £3,000,000,000 gross and £2,852,000,000 net. The deposits of these banks before the war did not amount to more than £1,100,000,000 and their available resources were £300,000,000. Banking credits were created every time government loans were taken up by banks on their own accounts, or when the banks made advances to their customers to enable them to subscribe for government loans. The process was peripatetic. It resembled a wheel, that revolving, came around to the same place. The banks placed in the wheel the payments which they made to the credit of the government and the subscribers received government securities. The government, in its turn, placed in the wheel the checks which it issued in payment for commodities and services, and the creditors who received the checks used the wheel to carry

[1] *Parliamentary Debates,* H. C., January 26, 1917.

the checks back to the bank where they were placed to their credit in the banks and thus reestablished the banks' reserves and prepared them for another government loan. Where the depositors used their deposits to subscribe for loans, the revolutions of the wheel showed that these deposits were merely transferred to the government and after disbursement by the government found their way back to the joint stock banks through the accounts of government contractors. The same credit thus went around the wheel so long as its different owners were willing to take government loans, and during each revolution of the wheel an additional amount of loan was paid for.

> The government all through has financed the war too much on borrowed bank money; (1) from the Bank of England—the people's money twice removed—the worst form of bank credit inflation; (2) from the banks for investment in the first and second war loans—the people's money once removed—a vicious form of bank credit inflation, because bank deposits should be used mainly for trade advances, and should not be locked up in long dated government securities; (3) from the subscribers to the third War Loan who borrowed the money to subscribe from the banks the pledging of the people's future savings to find money for government expenditure—an unwise use of the people's power to save, an inverse ratio of sound wartime finance.[1]

It thus appears that inflation has taken place so that the controversy in England centered about the question whether it could have been helped and whether it could be at least reduced now that the country has entered upon a policy that produces inflation. The method now followed apparently increases the wealth of the country. The thing that actually happens is the enlargement of banking deposits, which, as potential currency, tend to increase prices.

Increase in Prices

The increase of prices is a serious matter in time of war because of its effect upon the population who produce the means

[1] D. Drummond Frazer in *London Economist,* August 4, 1917.

of carrying on the war. Various reports of the Commission of Inquiry maintain that rise of prices has had much to do with the growth of industrial unrest. In one of these reports prepared by the Commission of which Sir Alfred Booth, the Chairman of the Cunard Company, is a member, it is stated:

> The one outstanding cause of unrest which we find everywhere is the high cost of living, especially with regard to food. This is accompanied by complaints of exploitation, profiteering, and bad distribution.
>
> The initial cause of the rise in prices was the financial policy of the government, which has relied too much on loans—largely credit loans—and too little on taxation designed to check unnecessary consumption. The result has been a great inflation of credit followed by a very serious inflation of the currency. So long as the present financial policy is continued prices will continue to rise. It is admitted that income tax and supertax could not be substantially raised in general, or even more steeply graded, without a comprehensive reform with regard to the treatment of family incomes. The problem will, in any case, have to be faced after the conclusion of peace, and it should be tackled now in order to reduce our dependence on further inflation as a means of financing the war.
>
> Our attention was called to the contrast between the man who is compelled to serve as a soldier and the man who voluntarily lends to the government. It was tersely put to us that the soldier is compelled to serve at one shilling a day, while the man with money voluntarily lends to the government at 5 per cent. This, it is pointed out, is irritating and unjust. Another cause of irritation is the apparent luxury and ostentatious display of wealth.
>
> It is evident that after an experience of nearly three years many persons will not curb their extravagance and show of luxury.
>
> In order to remove the sense of irritation among workers and to assist the national exchequer, all unnecessary expenditure of the individual ought to be checked, and this can only be done by taxation or by forced loans.

For many years the *London Economist* has maintained an Index Number. An examination of the table for which the

years 1901-05 are used as a basis indicates a rapid and unparalleled change in prices. *The Economist* has classified products under the head of cereals and meats, and other food products (tea, sugar, etc.), textiles, minerals and miscellaneous (rubber, timber, oil, etc.). The basis total of the price of the products aggregated 2,200. At the end of July, 1914, the price was shown in 2,565 points. Up to May, 1917, this aggregate had more than doubled, showing 5,412 points or an increase of 246 per cent over the basic prices of 1901-05 and 230 per cent over the prices prevailing on August 1, 1914. The situation may be summarized as follows:[1]

	Group Total End May, 1917	Group Total End July, 1914	Rise since July, 1914, in Per Cent
Cereals and meats	1,376½	579	137
Other food products	648	352	84
Textiles	1,261½	616½	104
Minerals	839½	464½	81
Miscellaneous	1,286½	553	132
	5,412	2,565	111

A further statement bringing the Index down to February 1, 1918, shows a decline in cereals and meats of 155 points, other foods, such as tea, sugar, etc., have risen slightly; textiles in the period since May have risen 458 points; minerals have declined 10 points and miscellaneous items risen 43 points. These changes make the increase of prices 127.8 per cent since July, 1914.

Without question there has been an increase in prices and there has also been an increase in the money in circulation and in the bank credits available for purchase uses. Does the first phenomenon rest for its cause upon the second? This is the controverted point. Even so seasoned an authority as Mr. W. R. Lawson maintains that because prices have gone up there must have been an increase in the supply of money. With the withdrawal of men to the armies wages rose, but it is not to be taken seriously that it was necessary to materially enlarge the

[1] *London Economist,* June 9, 1917.

supply of notes and to multiply banking credits and enlarge the manufacture of check currency in order to supply wages.

> If all the money required for war purposes had been taken by the government either in taxes or in loans produced by genuine saving, then in so far as the purchasing power of the munition workers had been increased, the purchasing power of other classes of the community would have been diminished, and the rise in prices, though inevitable in certain commodities, would not have been general.

This is the conclusion of *The Economist*. The government by the use of paper issues and bank currency undoubtedly saved itself a good deal of trouble and pursued the easier path, but by such action it stimulated extravagance and materially enlarged the cost of the war.

This is of course a serious indictment. Could the war have been financed without inflation? Day by day, and year by year the cost of the war has mounted to untold figures. Industry has been disturbed and a vast expansion of activities taken place on account of government needs. The distribution of funds to these industries occasioned the initial enlargement of purchasing power. The use of the funds received by the heads of manufacturing concerns and the workers in them is the starting point of the inflation. If the funds are turned back into government securities, the resultant expansion may not be severe, but if the money is used for luxury the government must resort to many means of securing funds that ultimately result in expansion. At the present time the amount of £1 and 10s. notes is not far from £170,000,000. To this sum may be added the increase in banking deposits. The important phase of the matter, and the one that affects the problem of government, is the influence of the rise of prices in stimulating national unrest and forcing the government to enter upon an extended policy of food control.

The Select Committee of the House of Commons in their report (White Paper 167) do not think that the issue of paper money has had much effect in the expansion of credit. The high prices are due in their judgment to the lessening of production.

They give five reasons for the demand of the working classes for war bonuses or wage increases. The first of these is the cost of living; the second, the large profits of the employing class; the third, a supply of labor less than the demand; the fourth, the fact that the worker ought to have a larger wage because of increased output; and the fifth, that there should be equality of wages in all industries, which can only be attained by raising the wages to the standards prevailing in some favored industries. According to the figures of the Board of Trade food prices have increased 106 per cent and taking all items in the cost of living the increase is fully 85 per cent. Changes in dieting might reduce this to 53 per cent, and deducting the taxes on consumers to 50 per cent. An inquiry into the whole matter by a commission with liberal representation of labor is, in the opinion of the Committee, necessary before anything real can be done about adjusting prices and wages.

Prices and Separation Allowances

What are called the prevailing high prices of the necessaries of life have compelled the government to enlarge the rates of separation allowances payable for the children of sailors and soldiers. These additions to 2s. for the first child, 1s. 6d. for the second and third and 1s. for the fourth and each succeeding child. The amount thus available for petty naval officers with seven children was 28s. per week in addition to allowances from pay. The army allowances are higher but include allotments from pay. The total for the private with seven children reached in all 40s. and for noncommissioned officers a somewhat higher figure.[1] These statements are interesting because indicative of the changed view regarding government responsibility in time of war. In other days, not more than fifty years back, the soldier's family was left to shift for itself. The larger humanitarian view, while guarding the nation's heritage, nevertheless makes war more expensive to wage. On April 1, 1917, the Minister on Pensions had 700,000 cases on the books or in prospect.

[1] See *The Times*, January 19, 1917.

This statement did not include the children and wives of men in the field, but only the dependents of those who were disabled or killed at the front. As the war has gone on the ministry has found it necessary to raise the rates. Under the plan in vogue a widow under thirty-five will receive 13s. 9d. per week and additional amounts for the children. The pension plans of the English Government are well conceived and liberal. The scheme for direct pensions and widows' allowances will require not less than a capital account of £396,000,000 of which £25,000,000 must be provided in the first year.[1]

Pension Costs

The principle upon which the English Government proposed to give a pension to soldiers (not war allowances) is based upon service rendered and not upon the number of children he possessed. The services rest upon no other estimate than that of well done. All were to receive a flat rate pension supplemented by an allowance based upon earning capacity. Income was not considered, the basis of the supplemental pension was the man's earning capacity which was measured by his earnings during the twelve months prior to the war. To this general rule two exceptions were made, those of students and apprentices. In the case of the apprentice the wages were reckoned at the standard wage of the trade; similarly in regard to the student, if totally disabled, the assessment of his disability pension was at the flat rate of 27s. 6d. per week plus 5s. per week for each completed year at the hospital, college or university where he was being trained for his occupation or profession. There were allowances in addition as in the case of the man who required constant attendance that would give 20s. more per week. The result of the plan would allow a disability pension of 75s. in the most extreme instance and 27s. 6d. per week in the case of the man of low earning power.

Besides these burdens of increased costs of living, high prices,

[1] Second Report, Select Committee on National Expenditure, March 13, 1918.

pensions and allowances, are many others that follow in the trail of war. The greatest is the loss of life which in the case of Great Britain has reached a large figure, though it is below that of the French. The figures for England show a total of more than 500,000 of which 42 per cent have been killed, 40 per cent wounded and 18 per cent captured and missing. The man power loss to the United Kingdom is difficult to estimate, but on the low basis of £400 per man it reaches an appalling figure. Taking these together the burden, in addition to those imposed by taxation and the direct operations of the Treasury, is fully as great as that created by the expenditure for the support of armies in the field and ships on the seas. It is impossible to say how great, until an extended study of prices, pensions, costs, and man power losses and the depreciation of goods and property due to shifting conditions of industry can be undertaken.

CHAPTER IX

Scanning the Future

Democratic government has always emphasized the cooperative method of carrying on the affairs of the state. In ordinary times there is little difficulty in doing this. Perhaps, the interest in results is not quite so intense in peace times. At any rate, the divisions of government do not embarrass each other by over zealous scanning of each other's acts. In time of war the expenditures are larger, the acts of the Executive more arbitrary and, in consequence, greater possibilities of friction exist that lead to difficulties. Congress has given an excellent example of this statement. Feeling that large appropriations have disappeared like snow before a summer sun the members have called upon executive officers to give some account of their stewardship, and Congress, in turn, has endeavored to set up some supervising agency over them. In England a ministry backed by a majority of the House of Commons, and responsible to the House, would appear to be proof against friction and misunderstanding with the legislative branch. But the same situation exists there as in America. Members have the same feeling of remoteness from what is happening and exhibit irritation against the feeling of being in the dark.

Control of National Expenditures

During the past year and a half, Parliament has displayed greater intent of purpose to know what is going on, and to have a larger hand in the finances of the country. In June, 1917, as many as 187 members addressed a resolution to the Chancellor of the Exchequer in the following language:

> That a committee be appointed, consisting of members of this House with power to review all national expenditure, examine ministers and officials, and report to the House.[1]

It was proposed that this committee should consist of members of the House with a Treasury official as secretary, and that it should appoint several subcommittees who should review expenditure in government departments. The subcommittees were to report to the main committee, which was to decide whether the facts should be given immediate publication or be withheld until after the war. The approach to the problem of controlling national expenditure was to be from the business point of view with the idea of placing the members of the House in a position to know whether the nation was receiving value for its expenditure.

One instance of departmental expenditures illustrates the vastness of purchases and the possibilities of extravagance or economy. The War Office Contracts Department spent during three years (to July, 1917) more than £700,000,000. It bought 105,000,000 yards of cloth, 115,000,000 yards of flannel, 35,000,000 knives, forks and spoons, 400,000,000 pounds of bacon, 167,000,000 pounds of cheese, 500,000,000 rations of preserved meat, 35,000,000 boots, 25,000,000 smoke helmets, 40,000,000 horseshoes and many other things in proportion. In such transactions there were many opportunities both for economy and waste.[2] The very extent of the purchases and the absence of the customary budget, backed by the constant demands for economy by the press, really called for Parliamentary investigation in order that the country might be satisfied with the sacrifices it was making. In its first report of the 1917 session the Parliamentary Committee on National Expenditures contended that questions of cost should be taken into account in considering General Staff programs.[3] While it was argued that the General Staff could

[1] *London Economist*, June 2, 1917.
Special Report, Select Committee on National Expenditure, H. C., No. 125, August 1, 1917.
[2] *Ibid.*, June 7, 1917.
[3] First Report, Select Committee on National Expenditure, H. C., No. 151, October 24, 1917.

not be expected to take into consideration the matter of cost in deciding upon the desirability of strategical plans, nevertheless, the Committee concluded that finance is just one more element in the problem that under any conclusion involves man power, transportation and time, and hence, the status of the financial member of the Staff should be maintained, and in all meetings of the Army Council he should either be present or represented. They found also that the Financial Adviser in France was not in touch with the General Staff on matters pertaining to equipment. Seemingly, financial advice is needed on prices, manufacturing capacity, availability of labor, etc. It was also recommended that the War Finance Committee be revived and a review made of the heavy expenditures for forces in the United Kingdom by the War Cabinet. Likewise in the matter of munitions the Committee felt that there should be a Parliamentary Secretary charged with the finance of the ministry as in the case of financial secretaries to the Admiralty and War offices. More elaborate reports followed in December and March that dealt with parliamentary estimates and Treasury control.[1]

In time of war the system of expenditure has differed in many respects from the system in vogue in time of peace. No estimates are presented to the House of Commons by the War Department. The House votes the amount of money required by the expenditures asked for and, in consequence, the control of the Treasury over the spending departments is much less effective than in peace times. The uncertainties of war preclude a policy of tenders and the confining of expenditures within financial limits. It was the view of the Committee in its second report that it is incompatible with the public interest to require estimates in regard to the more important votes such as shipbuilding, armaments and naval works.[2] None of these considerations, however, applies to many branches of war expenditure, and the principle is unsound which does not permit effective control over

[1] Second Report, Select Committee on National Expenditure, H. C., No. 167, December 13, 1917.

[2] *Ibid.*, p. 2.

such government expenditure. The Committee was, therefore, of the opinion that the degree of control exercised by the Treasury fell far short of the needs of the case. Reasons for this situation were advanced, one of them being that the Treasury staff was too small and the task beyond its strength. It seemed desirable to correct this situation by providing a sufficient staff and requiring the Treasury to exercise a more efficient control over departments so as to insure the adoption of sound financial methods in every province of administration. Matters of profits, wages and prices were given consideration by the Committee. No new advances in wages should be made without careful study of the situation and when so made should apply to all industries. Profits should be limited and the provisions for control materially strengthened, and so far as possible, the government should avoid the creation of new credits in financing the war.

Conclusions of Committee on War Expenditures

A more extended examination of the Committee's viewpoint will show the difficulties of war undertakings when viewed from the financial side.

The greatest of the spending ministries is that of Munitions.[1] This ministry remains, says the Committee,

> a great buying and selling concern. In practically every branch of its activity, expenditure of money is involved. Its principal expenditure is still by contract in the purchase of commodities, raw, semi-manufactured or completely manufactured.

In all these matters the ministry are practically the tax payers' only security that their money is wisely spent. The Committee was unable to find that sufficient recognition of the trustee relationship had been accepted by the Munitions Ministry. This statement also applies to the other expending agencies. In consequence the attitude of supply and finance branches ought to be that of close friends and eager helpers. This the Committee did

[1] Report: Session, 1918, Select Committee on National Expenditure, No. 23, March 6, 1918, p. 4.

not find to be wholly true. Had it been the case the supply departments would have afforded every assistance to the finance branches in the work they were doing instead of too often regarding them as an actual hindrance.

Since somebody must pay the bill the Committee reports that Treasury control must in the last analysis be a sanctioning control, particularly as applicable to capital expenditure. Large sums up to date have been spent by the Munitions Ministry in the form of capital expenditure. The latest computation places such expenditure by this one ministry for national factories at £66,000,000. Grants to private firms for capital expenditures amount to £16,000,000, and £17,000,000 was spent for tools and equipment besides additions to private plants that must be paid for on the basis of allowances varying up to 100 per cent from excess profits. Attempts were made by the minister in February, 1917, to supervise capital expenditures in relation to finance upon a proper basis by creating a board to consider expenditures by controlled establishments when the amounts were more than £500. But evidence of the chairman points to the fact that this board was compelled to accept the word of the head of the supply department involved in the transaction.[1] Under the date of March 6, 1918, the report of the Committee states that in the last few weeks the functions of the Munitions Works Board have been considerably modified. Under the new procedure all cases involving £10,000 or more must be referred by this board to the Controller of Munitions Finance, and where the amount is £50,000 or upwards the proposal must be submitted to the Treasury for sanction. Despite these provisions the Committee are not confident that they will secure any real improvement. In their opinion multiplication of reference not only adds largely to delay, but it also weakens responsibility.

These statements make interesting reading in view of discussions in Congress on the cost of the war and the recent Borglum incident in connection with the flying program. In America the evidence indicates procedure without adequate accounting or fi-

[1] *Ibid.*, p. 7.

nancial control. The English have learned the dangers accompanying such lack of coordination. If the proper steps had been taken in the beginning the present spasms of reform in the English system would not now be necessary. The difficulty lies in the failure to consider necessity and financial sanction together.

> The proper authority for undertaking this consideration was and is the finance branch of the ministry. . . . The establishment of such a procedure would not only secure more satisfactory financial control in the interest of economy, but would actually assist in the production of munitions.

The problems of cost and profits, hitched as they are to the excess profits tax and the income tax, have been continually before the supply divisions and the finance departments. But little success has been secured in ascertaining the costs ot manufacture. Even the Chancellor of the Exchequer appears, according to the Committee, to be misinformed.[1] The finance branches in default of facts from the supply departments have used three methods: (1) that of making detailed examination of costs in national factories, (2) investigating cost of private firms by accountants, and (3) analyzing costs on the basis of ascertained times and places. There should be in view of the lack of real information a carefully organized cost investigation branch associated with the contracts branch. As to profits much uncertainty exists. While the excess profits tax and the munitions levy largely affected actual profits there is great variance in profits. In one case in 1917, a firm secured a profit of 27 per cent on the turnover before allowing for depreciation of 340 per cent on the capital. Many other instances might be cited indicating the difficulties and the care necessary to protect the National Treasury.

The transactions in the Munitions Ministry clearly indicate, as the Committee shows:[2]

(1) The predominant power of the supply branches.
(2) The ill effects of collective bargaining and flat rates.

[1] Report: Session, 1918, Select Committee on National Expenditure, No. 23, March 6, 1918, p. 10.
[2] *Ibid.*, p. 15.

(3) The necessity for full technical cost investigation.
(4) The advisability of taking into consideration a prewar standard of return on capital.
(5) The desirability of laying down fixed rates of profit.

Such specific statements made after more than three years of war show how essential financial organizations are to the effective direction of the war, and what is more, they point to the necessity of an early compliance with the sound wisdom worked out from the English experience.

The Policy of Continuous Borrowing

While Great Britain has settled down to the policy of continuous borrowing many advocates of heavier taxation have urged the government to exact a larger part of the war cost from the owners of wealth. Of late increasing numbers of proposals have been made suggesting a levy on capital or conscription of wealth. The thought behind this proposal has been more far reaching than to meet the day to day expenses of the conflict. It has had in mind the reduction of the postwar debt to manageable proportions. As the proposers have put it, the country faces an annual deficit of £260,000,000. Only the most drastic taxation can meet the demands that will be made on the Treasury. The alternative appears to be a capital levy. The editor of the *London Daily News,* Mr. Gardiner, sums the matter up in this form:

> The capital of the individuals of the nation has increased during the war from sixteen thousand millions to twenty thousand millions. A 10 per cent levy on this would realize two thousand millions. It would extinguish debt to that amount, and reduce the interest on debt by one hundred and twenty millions. In doing so it would nearly balance our budget and preserve our national solvency. The levy would be graduated—say, 5 per cent on fortunes of £1,000 to £20,000, 10 per cent on £20,000 to £50,000, up to 30 per cent on sums over a million . . . [The individual] would pay it in what form was convenient, in his stocks or his shares, his houses, or his fields, in personalty or realty.[1]

[1] *London Daily News,* September 15, 1917.

Capital Taxation

These proposals have taken a more definite and serious form in the last six months. The War Emergency Workers' National Committee in common with the Trades Union Congress, the Labor Party and the Industrial Triple Alliance are demanding "definite conscription of riches as a substitute for the raising of more money on loan." The Committee suggests three methods:

(1) A capital tax graduated to 20 per cent; a death duty on everybody who dies with property of £300 or more.

(2) Double the present income and supertax.

(3) Sequestrate all unearned income, establishing a public trustee to provide subsistence allowances.

It will be seen that what appeared as a theory of justice is now shaping itself into a political demand that may be forced upon the government as a financial policy.

Without going into the question of the accuracy of the statement regarding the increase of individual capital holdings it is sufficient to consider the principle involved. The state must first acquire the part of the wealth it is proposed to take. This is in many forms. The supposition is that the owner would pay the levy made upon him either by check on his bank account or by the sale of his property. This would involve many difficulties of a far reaching character, leading to the lowering of prices and the demoralization of the market for such commodities. If the state entered upon this project the simpler method would be to require all holders of property to pay the levy made against them in government scrip. If not paid out of property holder's income the scrip would have to be acquired by loans from banks, enormously increasing the inflation now complained of. In the final analysis such a levy is in fact an income tax based on property whose valuation at any time is a matter of great difficulty. It has long been recognized that an income tax is superior to a property tax, for it deals justly between spenders and savers.[1]

[1] *London, Economist,* September 15, 1917.

The levy on capital, however, throws the burden upon those who have saved and accumulated, striking at the very foundation of the nation's capital fund.

The basis for this suggestion rests upon two propositions. One is that the wealth of a man being measured in money can be easily translated into money. The other springs from the antagonism between capital and labor expressed in the view that if the manhood of the country is conscripted so should its wealth be taken.[1] Between the two there is no analogy, for the seizure of wealth reduces the producing power upon which the nation must depend for the very income which is required for the conduct of the war. The argument undoubtedly points to a heavier income tax or a special tax upon the wealthier classes. The difficulties in the way of a levy on capital are so great as to force the state to use every effort to secure additional income by heavier taxation.

While taxation in Great Britain has been, compared with peace times, heavy, yet it is the opinion of an increasing school that it could be still heavier with advantage to the country. "Obviously," says *The Economist,* "taxation is the means of paying for the war which does least harm both after war and during it, and in this respect Mr. Bonar Law has backslid seriously from his predecessor's not too courageous record." The viewpoint of Mr. Bonar Law is that you can not get both loans and taxes. "In my belief," he says, "nothing could be worse for the country than to lay your taxation upon such an overwhelming basis that every means of carrying on would be taken away altogether." [2]

Ratio of Taxes and Borrowings

Just what proportion should be maintained between borrowings and the amount to be raised by taxation can not be determined, especially when the end of the war is not in sight. There is, however, a choice between paying by present taxation or by taxation in the future. War makes no return of products for

[1] *The Annalist,* October 19, 1917.
[2] *London Economist,* July 21, 1917.

the outlay and it ought therefore be paid for as it goes on, so far as possible. The experiences in previous wars afford no help in the solution of the difficulty because of the vast sums expended in this war. Certainly, one fundamental principle appears out of it all, and that is that the interest on the debt must be paid out of taxation. There are two other charges that should be faced in the same way, these are the maintenance of an adequate sinking fund and the cost of pensions for disabled men and widows and orphans. In time of war a nation can bear higher taxes than in peace. As the war goes on the rate of interest increases and the government expenditures are more lavish out of borrowed money than out of money raised by taxation.

No one has urged an exclusive loan policy for the reason that public credit depends upon the willingness of the government to support its loans by substantial taxation, which in turn checks private expenditures and holds back the pushing force of rising prices.[1] The English Government's long experience pointed the way to a loan policy at the outset, since taxation adjusts itself slowly to the changed conditions and income must be had at the start. That there was too much delay in inaugurating a more adequate system of taxation is pretty well maintained by the facts. The short term notes used so extensively required a constant resort to bank funds to finance them and added to the inflation process. The longer term bonds proved a more satisfactory method of securing funds. In fact the government found that the three-month Treasury notes and the three-year Exchequer bonds fell due at periods so short that they embarrassed the larger operations. Great Britain has had the advantage of foreign borrowing, and so has been able to supplement her tax revenues not only by the borrowings from her own people but from the United States as well. How soon this door will be closed is a matter of conjecture. The steadily mounting war costs in America will increase the difficulty of foreign borrowing and force her to rely upon savings and taxation more extensively

[1] See Article of C. J. Bullock, *Quarterly Journal of Economics*, May, 1917.

than she has yet done. The adherence therefore to abundant taxation, and a wise system of loans are absolutely necessary to the continuance of the war. The continuous loan policy has succeeded fairly well, but the coming year will compel a still greater effort and larger sacrifices in taxation.

The budget speech of Mr. Bonar Law on April 23, 1918,[1] confirmed this conclusion. At the time when he took office, 1916, the budget was £2,000,000,000 in round numbers, the proposed budget for 1918-19 is calculated at £2,972,000,000. The calls from the Allies for financial help continued just as great as before, despite the defection of the Russians and the help of the United States. The new budget abandons the penny post and doubles it, places a tax on cheques, proposes a tax on luxuries and the placing of farmers under the provisions of the income tax, with some additional modifications whose details are not available at this writing. The income tax remains as before and no change was made in the excess profits tax of importance. The Chancellor is resting heavily upon the returns from the continuous loans.

Future Commerce and Trade

Although faced by such serious problems of immediate import Great Britain is looking to the future. She does not concede the New York claim that financial ascendency has passed to that city.

> New York, it is true, in recent years has made small loans to China and Japan; and considerable capital has been invested in Canada. Nevertheless, the United States will have a very serious situation itself to face during the course of the war, as far as finances are concerned. During the next eighteen months the Republic must find \$750,000,000 to refund maturing obligations—mostly industrial and railroad bonds and short-time notes. Then, again, to that must be added a sum of at least \$450,000,000, for the eighteen months' period, as the United States normally receives from Europe, for investment purposes, about \$300,000,000 a year. When one recalls the very great difficulties which

[1] *Parliamentary Debates,* H. C., same date.

> one of the richest cities in the United States had to meet in securing $40,000,000 to discharge obligations to English creditors at the outbreak of the war, it will be seen how absurd are the contentions of a certain section of the American press and people that New York can, or will, displace London as the world's banking and investment center after the war. No doubt in the years to come, when the home market has become saturated with capital, the United States, as the wealthiest single nation in the world will have a great role to play in the field of foreign investments.[1]

This statement of Mr. Swanson's was written in the early days of the war. Since then New York has financed the Anglo-French loan, Russian and Italian loans. The Government of the United States up to April 1, 1918, has extended credit of $2,500,000,000 to the English Government and the American securities held in England have been in a large measure reabsorbed in this country. The situation has markedly changed and given a new emphasis to the earlier exaggerated claims of our financial metropolis to world leadership.

A vast scheme is now under way to meet financial, trade and social problems after the war. The British Ministry of Reconstruction has completed a list of commissions and committees that have been set up to deal with questions which will arise at the close of the war.[2] These include development of trade, need of raw materials and building supplies, engineering, finance, education, scientific and industrial research, labor and employment, housing, national registration, foods, an Empire Settlement Committee and civil aerial transport. It is evident that Great Britain does not propose to be any less of a factor in world affairs than she has been. Her viewpoint is worldwide, and before the end of the war is in sight her statesmen are looking to the future in a definite and far sighted way.

[1] W. W. Swanson: *The Financial Power of the Empire,* p. 24.
[2] *Official Bulletin,* March 14, 1918.

Lessons of English Experience

Perhaps the first great lesson of the war as judged by English experience is contained in the matter of fact statement in the preceding paragraph. It is none too soon to look to the future. It is already apparent that the United States must lay down broad principles for the legislation and policy on labor questions. The feeling of unrest abroad is apparent here. The labor problem must be solved from a national point of view. Great as has been the contribution of public education to the war it needs reorganization and readjustment to national life. In addition are the many questions of food and material conservation that also must be looked at as national questions instead of matters of private concern. Specifically, the study of the financial side of the English Government's activities during the war marks some things as distinctly clear. The first of these is the necessity for an adequate and carefully considered system of taxation at the beginning of the war, gradually expanding in its resultant income; second, a consistent and thorough-going system of borrowing based on principles of sound finance rather than upon the opportunism of the moment; third, Treasury control over general expenditures, coupled with thorough auditing and an advisory relation over direct expenditures; fourth, a financial minister whose whole time and ability can be given to financial problems; fifth, a systematic campaign for national economy and saving; sixth, a direct government control over manufacture of munitions and the transportation of them by rail and ship; seventh, the limitation of extravagant expenditure by taxation of both purchaser and dealer, and eighth, the establishment of a system of rationing at an early date.